

No. 16051 ✓

United States
Court of Appeals
for the Ninth Circuit

AMERICAN PROPERTIES, INC., and THE
ESTATE OF STANLEY S. SAYRES, de-
ceased, HAROLD L. SCOTT, and A. R.
MUNGER, Executors, and MADELEINE A.
SAYRES, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Petition to Review a Decision of The Tax
Court of the United States

FILED

SEP 3 - 1958

PAUL P. O'DRIEN, CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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Tax Court of the United States

Docket No. 57748

AMERICAN PROPERTIES, Inc., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency bearing symbols Ap:S:AA:90D-TRB:MHB dated February 17, 1955, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with its principal office at Seattle, Washington, its mailing address being Box 1893, Seattle 11, Washington. The returns for the years here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. The notice of deficiency, a copy of which is attached hereto, marked Exhibit "A", was mailed to the petitioner on February 17, 1955.

3. The deficiencies as determined by the Commissioner are in income taxes for the calendar years 1949 and 1950 in the respective amounts of \$495.78 and \$3,601.31, a total of \$4,097.09 for both years. The entire amount of the deficiencies is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

I. The respondent erred in disallowing for the

year 1949 the cost of taxes, maintenance, and operation of racing boats in the amount of \$2,155.56 as not being an ordinary and necessary business expense.

II. Respondent erred in not allowing as a deduction for the year 1949 a net operating loss carry-back from the year 1950 in the amount of \$1,561.41.

III. Respondent erred in not allowing as additional repair expense the amount of \$561.39 expended in 1949 and not claimed as a deduction on petitioner's original 1949 income tax returns.

IV. The respondent erred in disallowing for the year 1950 the cost of taxes, maintenance, and operation of racing boats in the amount of \$11,388.43 as not being an ordinary and necessary business expense.

V. The respondent erred in disallowing for the year 1950 depreciation on boats and related equipment in the amount of \$5,830.84 as not being assets used in the trade or business of petitioner and not held for production of income.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner was organized in 1931 under the laws of the State of Washington under the name of Williams Auto Company. Its name was later changed to American Properties, Inc. Article III of the original Articles of Incorporation sets forth the objects and purposes for which the corporation was formed and provides, among other things, "To buy, lease, deal in and deal with, store and repair automobiles and motor vehicles of all descriptions,

airplanes, motor boats and marine engines, bicycles, motoreycles, and all of their parts and accessories, and all articles and supplies used in connection therewith”.

(b) In 1949 petitioner decided to enter into the business of dealing in and dealing with motor boats and marine engines. Late in that year it purchased Slo-Mo-Shun III, Slo-Mo-Shun IV, and certain boat equipment for \$18,609.16.

(c) Petitioner expended the net amounts of \$2,155.56 and \$11,388.43 in the year 1949 and 1950, respectively, for taxes, maintenance and operating expenses of these boats. It claimed depreciation on the boats and equipment in 1950 as an ordinary and necessary business expense in the amount of \$5,830.84.

(d) Petitioner's original 1950 income tax return showed a loss from operations for that year in the amount of \$1,561.41. This amount should be allowed as a net operating loss deduction for the year 1949. On June 29, 1951 petitioner filed a claim for refund for the year 1949 in an attempt to recover the overpayment of 1949 taxes paid resulting from the carry-back of the 1950 net operating loss. Respondent has not allowed the refund.

(e) Repair expense in the amount of \$561.39 was expended in 1949 and erroneously charged to the American Automobile Company and not claimed as a deduction on petitioner's 1954 income tax return. On August 19, 1952 petitioner filed a claim for refund to recover the overpayment of 1949 income taxes resulting from the understatement of operat-

ing expenses for the year 1949 by the amount of \$561.39. Respondent has not allowed the refund.

Wherefore, petitioner prays that this Court may hear the proceeding and that the case be set for trial at Seattle, Washington; that it find that the respondent has erred in the respects and to the extent stated in paragraph 4, *supra*; that there is no deficiency in Federal income tax due from the petitioner for either one of the years 1949 or 1950; that petitioner is entitled to a refund of a portion of the taxes paid by it for the year 1949 and that this Honorable Court may enter its order accordingly, and/or give such other and further relief, as, in the judgment of this Court, may be fit and proper.

/s/ TRACY GRIFFIN,

/s/ HAROLD L. SCOTT,

Counsel for Petitioner.

Duly Verified.

EXHIBIT "A"

Form 1230 (App.)

123 United States Court House
Seattle 4, Washington

Ap:S:AA:90D

February 17, 1955

American Properties, Inc.

Box 1893, Seattle 11, Washington

Gentlemen:

You are advised that the determination of your

Exhibit "A"—(Continued)

income tax liability for the taxable year(s) ended December 31, 1949, and December 31, 1950, discloses a deficiency or deficiencies of \$4,097.09 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 123 U. S. Court House, Seattle 4, Washington. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Exhibit "A"—(Continued)

Very truly yours,

T. COLEMAN ANDREWS,

Commissioner, Internal Revenue,

/s/ By JAMES E. WESTIN,

Associate Chief, Appellate Division.

Enclosures: Statement, Form 1276, Agreement
Form.

STATEMENT

Ap:S:AA:90D

TRB:MHB

American Properties, Inc.

Box 1893

Seattle 11, Washington

Tax liability for taxable years ended December 31, 1949 and
December 31, 1950.

Year	Liability	Income Tax	
		Assessed	Deficiency
1949	\$2,333.13	\$1,837.35	\$ 495.78
1950	3,601.31	None	3,601.31
Totals	\$5,934.44	\$1,837.35	\$4,097.09

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated June 18, 1952; to your protest dated May 12, 1953; to the statements made at the conferences held on March 31 and August 30, 1954; and to your claims for refund filed on June 29, 1951, and August 19, 1952.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issues set forth in your claims for refund should be made a part of the petition to be considered by The Tax Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the 1939 Internal Revenue Code.

Exhibit "A"—(Continued)

A copy of this letter and statement has been mailed to your representative, Mr. Harold L. Scott, Stuart Building, Seattle 1, Washington, in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended December 31, 1949

Adjustments to Net Income

Net income disclosed by return, Form 1120	\$ 8,423.26
Unallowable deductions and additional income:	
(a) Boat expenses	2,155.56
	<hr/>
Net income adjusted	\$10,578.82

Explanation of Adjustments

(a) Included in deductions on the corporation's return was the cost of taxes, maintenance, and operation of racing boats in the total amount of \$2,155.56. It has been determined that such expenses were not ordinary and necessary business expenses and therefore not allowable as deductions. Net income is increased accordingly.

Computation of Tax

Net income adjusted	\$10,578.82
Normal tax and surtax net income	10,578.82
Normal tax:	
15 per cent of \$5,000.00	\$ 750.00
17 per cent of \$5,578.82	948.40
	<hr/>
Total normal tax	1,698.40
Surtax:	
6 per cent of \$10,578.82	634.73
	<hr/>
Income tax liability	\$ 2,333.13
Assessed:	
Orig. Acct. No. 6410036	1,837.35
	<hr/>
Deficiency	\$ 495.78

Exhibit "A"—(Continued)

Taxable Year Ended December 31, 1950

Adjustments to Net Income

Net income (loss) disclosed by return, Form 1120	\$ (1,561.41)	
Unallowable deductions and additional income:		
(a) Boat expenses	\$11,388.43	
(b) Boat depreciation	5,830.84	17,219.27
		<hr/>
Net income adjusted		\$15,657.86

Explanation of Adjustments

(a) Included in deduction on the corporation's return was the cost of taxes, maintenance, and operation of racing boats in the net amount of \$11,388.43. It has been determined that such expenses were not ordinary and necessary business expenses and therefore not allowable as deductions. Net income is increased accordingly.

(b) Included in deductions on the corporation's return was depreciation on boats and related equipment in the amount of \$5,830.84. It has been determined that those assets were not used in the trade or business of the corporation and were not held for the production of income. Depreciation on such assets is not allowable. Net income is therefore increased by the above \$5,830.84.

Computation of Tax

Net income adjusted	\$15,657.86
Combined normal tax and surtax:	
23 per cent of \$15,657.86	\$ 3,601.31
Income tax liability	\$ 3,601.31
Assessed:	
Orig. Acct. No. 9204706	None
	<hr/>
Deficiency	\$ 3,601.31

Served: May 11, 1955.

[Endorsed]: T.C.U.S. Filed May 11, 1955.

[Title of Tax Court and Docket No. 57748.]

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein, admits and denies as follows:

1. Admits that the petitioner is a corporation with its only office at Seattle, Washington, its mailing address being Box 1893, Seattle 11, Washington. Admits that the returns for the years here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. Admits the allegations of paragraph 2 of the petition.

3. Admits the allegations of paragraph 3 of the petition.

4. I. to V. Denies the allegations of paragraphs 4. I. to V., inclusive, of the petition.

5. (a) and (b). Denies the allegations of paragraphs 5 (a) and (b) of the petition.

(c) Denies the allegations of paragraph 5 (c) of the petition except it is admitted that petitioner claimed depreciation on "the boats and equipment" in 1950 as an ordinary and necessary business expense in the amount of \$5,830.84.

(d) Denies the allegations of paragraph 5 (d) of the petition except it is admitted that petitioner's original 1950 income tax return showed a loss from operations for that year in the amount of \$1,561.41, and that on June 29, 1951 petitioner filed a claim

for refund for the year 1949, which claim for refund has not been allowed by the respondent.

5. (e) Denies the allegations of paragraph 5 (e) of the petition except it is admitted that on August 19, 1952 petitioner filed a claim for refund for the taxable year 1949 in the amount of \$129.11, which claim for refund has not been allowed by the respondent.

6. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified or denied.

Wherefore, it is prayed that the relief sought in the petition be denied and that the deficiencies in income taxes for the taxable years 1949 and 1950, as set forth in the notice of deficiency, be in all respects approved.

/s/ JOHN POTTS BARNES, WHP,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
Gordon N. Cromwell, Special Attorney, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed July 6, 1955.

Tax Court of the United States

Docket No. 57751

STANLEY S. SAYRES AND MADELEINE A.
SAYRES, husband and wife, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiencies and penalty set forth by the Commissioner of Internal Revenue in his notice of deficiency bearing symbols Ap:S:AA:90D-TRB:MHB dated February 17, 1955, and as a basis of their proceeding allege as follows:

1. Petitioners are individuals residing in Bellevue, Washington, their mailing address being Route 1, Box 325, Bellevue, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. The notice of deficiency, a copy of which is attached hereto, marked Exhibit "A", was mailed to the petitioners on February 17, 1955.

3. The taxes in controversy are for income taxes for the fiscal years ended October 31, 1949, and October 31, 1950, in the respective amounts of \$10,400.69 and \$12,830.51, a total of \$23,231.20 for

both years. The penalty in controversy has been asserted under Section 293(a) of the Internal Revenue Code (1939) for the fiscal year ended October 31, 1950 in the amount of \$641.53.

4. The determination of taxes and penalty set forth in said notice of deficiency is based upon the following errors:

I. The respondent erred in increasing petitioners' "other income" in the amount of \$16,401.51 for the year ended October 31, 1949. Respondent explains this adjustment as "It has been determined that you received taxable income of \$16,401.51 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly." Since the composition of the amount of \$16,401.51 has not been explained other than set forth above in respondent's statutory notice of deficiency, such arbitrary procedure compels petitioners to deny the same.

II. The respondent erred in increasing petitioners' "Other income" in the amount of \$16,595.31 for the year ended October 31, 1950. Respondent explains this adjustment as "It has been determined that you received taxable income in the total amount of \$16,595.31 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly." Since the composition of the amount of \$16,595.31 has not been explained other than set forth above in respondent's statutory notice of deficiency, such

arbitrary procedure compels petitioners to deny the same.

III. The respondent erred in increasing salary income by the amount of \$3,200.00 for the year ended October 31, 1950.

IV. The respondent erred in asserting the penalty provided for in Section 293(a) of the Internal Revenue Code (1939).

5. The facts upon which the petitioners rely as the basis of this proceeding are as follows:

(a) Petitioners did not receive taxable income in the amount of \$16,401.51 from American Properties, Inc. which they failed to report in the year ended October 31, 1949.

(b) Petitioners did not receive taxable income in the amount of \$16,595.31 from American Properties, Inc. which they failed to report in the year ended October 31, 1950.

(c) In December 1949, Jen-Cel-Lite Corporation authorized petitioner, Stanley S. Sayres, a salary of \$800.00 per month, effective July 1, 1949. Since \$3,200.00 of this salary was paid for services rendered during the months of July, August, September and October, 1949, this amount should not be included in petitioners' income for the year ended October 31, 1950.

Wherefore, petitioners pray that this Court may hear the proceeding and that the case be set for trial at Seattle, Washington; that it find that respondent has erred in the respects and to the extent

stated in paragraph 4 supra; and that this Honorable Court may enter its order accordingly, and/or give such other and further relief as, in the judgment of this Court, may be fit and proper.

/s/ TRACY GRIFFIN,

/s/ HAROLD L. SCOTT,

Counsel for Petitioners.

Duly Verified.

EXHIBIT "A"

Form 1231 (App.)

U. S. Treasury Department
Internal Revenue Service, Regional Commissioner,
123 United States Court House, Seattle 4,
Washington.

In Replying Refer to

Feb. 17, 1955

Ap:S:AA:90D-TRB:MHB

Mr. Stanley S. Sayres and Mrs. Madeleine

A. Sayres

Husband and Wife

Route 1, Box 325

Bellevue, Washington

Dear Mr. and Mrs. Sayres:

You are advised that the determination of your income tax liability for the taxable years ended October 31, 1949 and October 31, 1950 discloses deficiencies in tax aggregating \$23,231.20 and a penalty of \$641.53 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Exhibit "A"—(Continued)

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 123 U. S. Court House, Seattle 4, Washington. The signing and filing of this form will expedite the closing of your case by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

T. COLEMAN ANDREWS,

Commissioner, Internal Revenue,

By

Associate Chief, Appellate Division.

Enclosures: Statement, Form 1276, Agreement
Form.

Exhibit "A"—(Continued)

STATEMENT

Ap:S:AA:90D—TRB:MHB

Mr. Stanley S. Sayres and Mrs. Madeleine A. Sayres
 Husband and Wife
 Route 1, Box 325
 Bellevue, Washington

Tax liability for the taxable years ended October 31, 1949
 and October 31, 1950.

Year	Income Tax	Sec. 293(a)
	Deficiency	Penalty
October 31, 1949	\$10,400.69	None
October 31, 1950	12,830.51	\$641.53
Total	<u>\$23,231.20</u>	<u>\$641.53</u>

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated June 18, 1952; to your protest dated December 18, 1952; and to the statements made at the conferences held on March 31 and August 30, 1954.

It has been determined that you are liable for a penalty of \$641.53 under the provisions of section 293(a) of the 1939 Internal Revenue Code for the taxable year ended October 31, 1950.

A copy of this letter and statement has been mailed to your representative, Mr. Harold L. Scott, Stuart Building, Seattle 1, Washington, in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended October 31, 1949

Adjustments to Net Income

Net income disclosed by return, Form 1040		\$42,782.07
Unallowable deductions and additional income:		
(a) Depreciation	\$ 246.59	
(b) Other income	16,401.51	
(c) Contributions	100.00	
(d) Interest	1,553.75	
(e) Taxes	1,434.62	19,736.47
		<hr/>
Net income adjusted		\$62,518.54

Exhibit "A"—(Continued)

Explanation of Adjustments

(a) 1. It has been determined that the depreciation claimed on East Union Street building improvements is excessive in the amount of \$267.90.

2. It has been determined that the depreciation of improvements on Hunts Point property is \$500.94 instead of \$479.63, or \$21.31 more than that claimed in your return.

1. Depreciation of East Union Street building improvements overstated	\$267.90
2. Depreciation of Hunts Point property improvements understated	21.31

Net additional income \$246.59

(b) It has been determined that you received taxable income of \$16,401.51 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly.

(c) The amount of \$100.00, claimed as a deduction in your return for contributions paid to Detroit International Regatta Association is held not deductible under the provisions of Section 23(o) of the 1939 Internal Revenue Code. Your taxable net income is therefore increased by such amount.

(d) It has been determined that interest of \$1,553.75 paid on a loan to purchase a single premium life insurance contract and claimed as a deduction in your return is not deductible. Your taxable net income is therefore increased by such amount.

(e) It has been determined that you overstated the deduction for taxes paid in the net amount of \$1,434.62, computed as follows:

1. Included in the deduction for State and city business, sales, and excise taxes is the amount of \$4,189.04 claimed as miscellaneous taxes appertaining to construction work performed under contract on your residential properties. Since such taxes are levied against the contractor, they are not an allowable deduction in computing your taxable net income.

2. Washington State sales taxes in the total amount of \$3,743.92 paid by you on the construction work performed is allowed as a deduction in computing your taxable net income.

3. The amount of \$1,412.28, represented in your return as payroll taxes, has been determined to be Social Security taxes and contributions imposed on the contractor and therefore un-

Exhibit "A"—(Continued)

allowable as a deduction in computing your taxable net income.

4. You are allowed a deduction of \$422.78 for Washington State sales taxes paid for your benefit by American Properties, Inc.

Summary of adjustments:

1. Unallowable State and city business, sales and excise taxes:		
Brewster house	\$	563.31
New house		3,625.73
Total	\$	4,189.04
2. Allowable State sales taxes on construction work:		
Brewster house	\$	510.40
New house	3,233.52	(3,743.92)
3. Unallowable payroll taxes		1,412.28
4. State sales taxes paid by American Properties, Inc.	(422.78)
Net additional income	\$	1,434.62

Computation of Alternative Tax

Net income adjusted	\$62,518.54
Less: Exemptions	1,200.00
Balance	\$61,318.54
One-half of balance	\$30,659.27
Minus: One-half of net long-term capital gain	314.25
Income subject to tentative tax	\$30,345.02
Tentative tax	\$13,433.91
Less: \$68.00 plus 12 per cent of \$13,033.91	1,632.07
Balance	\$11,801.84
Combined partial normal tax and surtax— \$11,801.84 times 2	\$23,603.68
Add: one-half of net long-term capital gain	314.25
Income tax liability	\$23,917.93
Liability disclosed by return:	
Original Acct. No. 2319301	13,517.24
Deficiency	\$10,400.69

Exhibit "A"—(Continued)

Taxable Year Ended October 31, 1950

Adjustments to Net Income

Net income disclosed by return, Form 1040		\$59,901.25
Unallowable deductions and additional income:		
(a) Salary	\$ 3,200.00	
(b) Depreciation	156.52	
(c) Other income	16,595.31	
(d) Capital gain	1,493.00	
(e) Interest	1,553.75	22,998.58
<hr/>		<hr/>
Total		\$82,899.83
(f) Dividends	\$ 50.00	
(g) Taxes	292.37	342.37
<hr/>		<hr/>
Net income adjusted		\$82,557.46

Explanation of Adjustments

(a) It has been determined that you received a salary of \$12,800.00 from the Jen-Cel-Lite Corporation whereas you reported income of \$9,600.00 from that source on your return. Accordingly, net income is increased by \$3,200.00, the difference between the above two amounts.

(b) 1. It has been determined that the depreciation claimed on East Union Street building improvements is excessive in the amount of \$267.90.

2. It has been determined that the depreciation of improvements on Hunts Point property is \$1,502.81 instead of \$1,391.43, or \$111.38 more than that claimed in your return.

1. Depreciation of East Union Street building improvements overstated	\$267.90
2. Depreciation of Hunts Point property improvements understated	111.38
<hr/>	

Net additional income \$156.52

(c) It has been determined that you received taxable income in the total amount of \$16,595.31 from American Properties, Inc., which you failed to report as income on your return. Net income is increased accordingly.

(d) On your return you reported taxable long-term capital gain in the amount of \$3,638.00 on the sale of residential prop-

Exhibit "A"—(Continued)

erty at 3140 E. Laurelhurst Drive, Seattle. It has been determined that your correct income from that source was \$5,131.00. Accordingly, net income is increased by \$1,493.00, the difference between the above two amounts.

(e) It has been determined that interest in the amount of \$1,553.75 paid on a loan to purchase a single premium life insurance contract and claimed as a deduction in your return is not an allowable deduction. Your taxable net income is therefore increased by such amount.

(f) It has been determined that you received taxable dividends from Willys-Overland Company in the amount of \$450.00. Since you reported dividend income of \$500.00 from this source, your taxable net income is reduced \$50.00.

(g) You are allowed a deduction of \$292.37 for taxes paid for your benefit by American Properties, Inc. as follows:

Washington State sales tax paid in period	
11/1/49 to 12/31/49	\$ 81.17
Washington State sales tax paid in period	
1/1/50 to 10/31/50	185.20
Trailer license paid in period 1/1/50 to 10/31/50	26.00
	<hr/>
Total	\$292.37

Computation of Alternative Tax

Net income adjusted	\$82,557.46
Less: Exemptions	1,200.00
	<hr/>
Balance	81,357.46
One-half of balance	\$40,678.73
Minus: One-half of net long-term capital gain	1,990.59
	<hr/>
Income subject to tax	\$38,688.14
Tentative tax computed at rates in effect prior to 10/1/50:	
Combined normal tax and surtax on \$38,688.14	\$18,834.82
Less: \$68.00 plus 12 per cent of \$18,434.82	2,280.18
	<hr/>
Balance	\$16,554.64
Total tentative tax computed at rates in effect prior to 10/1/50—\$16,554.64 times 2	\$33,109.28

Exhibit "A"—(Continued)

Tentative tax computed at rates in effect after 9/30/50:	
Combined normal tax and surtax on \$38,683.14	\$18,834.82
Total tentative tax computed at rates in effect	
after 9/30/50—\$18,834.82 times 2	\$37,669.64
Portion of tentative tax computed at rates prior	
to 10/1/50 applicable:	
11/12 of \$33,109.28	\$30,350.17
Portion of tentative tax computed at rates after	
9/30/50 applicable:	
1/12 of \$37,669.64	3,139.14
<hr/>	
Partial tax	\$33,489.31
Add: One-half of net long-term capital gain	1,990.59
<hr/>	
Income tax liability	\$35,479.90
Liability disclosed by return:	
Orig. acct. No. 9129504	22,649.39
<hr/>	
Deficiency	\$12,830.51

Served: May 11, 1955.

[Endorsed]: T.C.U.S. Filed May 11, 1955.

[Title of Tax Court and Docket No. 57751.]

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations of paragraph 1 of the petition.

2. Admits the allegations of paragraph 2 of the petition.

3. Admits the allegations of paragraph 3 of the petition.

4. I. to IV. Denies the allegations of paragraphs 4. I. to IV., inclusive, of the petition.

5. (a) to (c). Denies the allegations of paragraphs 5 (a) to (c), inclusive, of the petition.

6. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified or denied.

Wherefore, it is prayed that the relief sought in the petition be denied and that the deficiencies in income taxes and penalties for the taxable years ended October 31, 1949 and 1950, as set forth in the notice of deficiency, be in all respects approved.

/s/ JOHN POTTS BARNES, WHP,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
Gordon N. Cromwell, Special Attorney, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed July 6, 1955.

28 T. C. No. 127

Tax Court of the United States

AMERICAN PROPERTIES, INC., ET AL.,¹
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Nos. 57748, 57749, 57750, 57751. Filed
August 30, 1957.

FINDINGS OF FACT AND OPINION

Held, that the activities of the corporate petitioner in constructing, maintaining, and operating racing boats did not constitute the carrying on of a trade or business, but were incident to the personal hobby of its sole stockholder, and the corporation is not entitled to deduct amounts expended by it as ordinary and necessary business expenses, or to take deductions for depreciation on the boats. Held, further, that the amounts expended by the corporation are properly taxable to the individual petitioners, since such expenditures were solely for the personal benefit of the individual petitioner who was the sole stockholder. Held, further, that the indi-

¹ Proceedings of the following petitioners are consolidated herewith: American Properties, Inc., Docket No. 57748; Stanley S. Sayres, Docket No. 57749; Madeleine A. Sayres, Docket No. 57750; and Stanley S. Sayres and Madeleine A. Sayres, Docket No. 57751.

vidual petitioners omitted certain salary income from their returns, and that the respondent properly determined additions to tax on account thereof, pursuant to section 293(a), Internal Revenue Code of 1939.

Tracy Griffin, Esq. and Kenneth P. Short, Esq., for the petitioners.

Gordon N. Cromwell, Esq., for the respondent.

Atkins, Judge:

The respondent determined deficiencies in income tax and additions to the tax as follows:

Petitioner	Year Ending	Deficiency	Addition §293(a)
Stanley S. Sayres	Oct. 31, 1948	\$ 1,937.39	\$ 96.87
Madeleine A. Sayres	Oct. 31, 1948	1,906.23	95.31
Stanley S. and Madeleine A. Sayres	Oct. 31, 1949	10,400.69	None
Stanley S. and Madeleine A. Sayres	Oct. 31, 1950	12,830.51	641.53
American Properties, Inc.	Dec. 31, 1949	495.78	None
American Properties, Inc.	Dec. 31, 1950	3,601.31	None

American Properties, Inc. claims that there has been an overpayment in its tax for the year 1949.

The principal issue is whether certain expenditures made by the petitioner American Properties, Inc., in 1949 and 1950 in connection with designing, constructing, and racing of speed boats constituted deductible business expenses of the corporation, or whether such expenditures constituted personal hobby expenses paid by the corporation on behalf of its stockholder, the petitioner Stanley S. Sayres, taxable to him and his wife, the petitioner Made-

leine A. Sayres, and nondeductible by the corporation.

A second issue relating to the individual petitioners for the years 1948 and 1950 concerns omissions of salary income of the petitioner Stanley S. Sayres and additions to the tax for negligence relating to omissions of salary income.

Findings of Fact

The petitioners, Stanley S. Sayres and Madeleine A. Sayres, are husband and wife, and the petitioner American Properties, Inc., is Stanley S. Sayres' wholly-owned corporation. The individual petitioners reported their income on a fiscal year basis ending October 31. The corporation keeps its books and reports its income on a calendar year basis. The individuals filed separate income tax returns for the taxable year 1948 and filed joint returns for the taxable years 1949 and 1950. These returns and the returns of the corporation for the years 1949 and 1950 were filed with the collector of internal revenue at Tacoma, Washington. The petitioner Stanley S. Sayres is referred to hereinafter as the petitioner, or as Sayres, and the petitioner American Properties, Inc. is sometimes referred to hereinafter by name or as the corporation.

Prior to 1931 the petitioner was engaged in the automobile business in Pendleton, Oregon. In that year he went to Seattle and purchased Williams Auto Company, a corporation, the name of which he changed to American Properties, Inc. (one of the petitioners herein). During the years in ques-

tion he owned all the stock of the corporation except a qualifying share, which was held by his attorney. The petitioner also purchased stock of American Automobile Company. During the years in question he was also the principal stockholder of that corporation. That company operated an automobile dealership and was a tenant of premises owned by American Properties, Inc.

The petitioner has always enjoyed speed and it had been his desire to drive a boat faster than anyone had ever done before. Prior to going to Seattle he had engaged in outboard motor boat racing.

After moving to Seattle the petitioner for several years did not engage in boat racing. However, at some time prior to 1948 he purchased a used racing boat which had previously attained a speed of 80 m.p.h., and he named it Slo-Mo-Shun. Thereafter he built successively Slo-Mo-Shun II and Slo-Mo-Shun III. In the design, construction, operation, and maintenance of Slo-Mo-Shun III, the petitioner retained technical assistance of experts who were recognized as outstanding in their fields. Since Ted Jones, the boat designer, was employed on a full time basis as an engineer with an airplane company, his work for the petitioner was done at nights, on week ends, and on holidays. Anchor Jensen, of the local boat building firm, Jensen Motor Boat Company, was the builder. The petitioner, Jones and Jensen watched the 1948 Gold Cup races in Detroit in August 1948, and after their experience with the first Slo-Mo-Shun and Slo-Mo-Shun II and III they recognized the tremendous room

for improvement in the designing of racing boats. At that time they also recognized the possibility of profit to be made in the designing, construction and sale of racing boats. They considered the possibility that the Navy might become interested in the basic design of these fast boats and might become an important customer. Jones proceeded to design Slo-Mo-Shun IV which would be revolutionary in the field of unlimited hydroplane boats. He used the identical design which he had used for years in building and racing limited class boats. By August 1949, Jones and the petitioner concluded that Slo-Mo-Shun IV, which was then in the process of construction, would prove to be far superior to boats currently being used.

The petitioner had consulted his attorney, his accountant, and his financial adviser, an official of the Seattle-First National Bank, who all agreed on the profit possibility in the designing, building, and sale of boats. The banker advised against the petitioner's undertaking any such business enterprise in an individual capacity. In discussions with the attorney the petitioner suggested that inasmuch as the articles of incorporation of American Properties, Inc. already contained provisions which would authorize the construction and sale of boats and marine supplies or engines, such corporation might undertake the venture without the necessity of creating a new corporation.

The minutes of a meeting of the directors of the corporation held on August 31, 1949, contain the following:

Preliminary discussions had been had with reference to this corporation entering the field of boat building, ownership and management. Counsel reported that the Articles of Incorporation were sufficiently broad to warrant entry upon such a program.

Mr. Sayres in connection with the Country wide interest in power boat racing suggested that "Slo-Mo-Shun III" was in his opinion far superior to the major racing boats; that an improvement in design had been perfected and in his opinion "Slo-Mo-Shun III" was by no means the last word in the field. In other words, there would be continuous improvement and if sufficient time was devoted to experimental and engineering work other boats would become obsolete and the Seattle boat would be the pattern all over the Country.

He suggested that he believed if the Company would enter the field, do the necessary experimental and engineering work that not only was there money to be made in the manufacture and sale of racing crafts, but in the commercial field as well. That he believed the Government would itself be interested in the fastest type of boat that could be manufactured.

It was recognized that there would be substantial experimental cost to lay the groundwork for future development.

He further stated that he was willing to transfer title of Slo-Mo-Shun III to the corporation if the corporation would continue in an endeavor to work out improvements in design and engineering. He

particularly suggested that a new improved Slo-Mo-Shun should be designed and built for actual racing use.

Mr. Sayres also advised that he had substantial offers for Slo-Mo-Shun III and had no doubt of the salability of Slo-Mo-Shun the IVth and boats of that design and class.

It was agreed that it was to the best interest of the corporation to enter this new field and proceed with the construction of a new boat upon the improved design of Slo-Mo-Shun III, all with the end in view of when the time was propitious getting into commercial operation.

Mr. Sayres was authorized to proceed accordingly.

At this time Slo-Mo-Shun IV was in the process of being built. It was launched in October 1949.

At some time before October 31, 1949, the corporation paid to the petitioner an amount of \$14,690.30, which was the amount that had been expended by the petitioner in the construction of Slo-Mo-Shun III and of partial construction of Slo-Mo-Shun IV.

In 1949 there was no registration or licensing requirements with regard to boats of this character. The petitioner did not enter into any formal document transferring title of either Slo-Mo-Shun III or Slo-Mo-Shun IV to the corporation. There was no patent on the design of these boats.

The petitioner filled out forms with the county assessor of King County, Washington, for personal

property tax purposes, as of January 1, 1950 and 1951, indicating that he was the owner of Slo-Mo-Shun IV. The petitioner left blank the part of such forms calling for information as to whether he had transferred title. He belonged to the Seattle Yacht Club and has always been registered with the American Power Boat Association as the owner of Slo-Mo-Shun IV and V. The rules of that association provided, among other things, that each boat entered for a sanctioned race must be the bona fide property of the person in whose name she is entered, who must be a racing member of the association and a member of a club belonging to the association; that corporations or business concerns may not enter sanctioned races (although they may be members of the association) and may only enter a boat as the bona fide property of a club member who is also a racing member of the association, either by ownership or by charter.

On June 26, 1950, Slo-Mo-Shun IV, driven by the petitioner on Lake Washington, established a new world straightaway speed record of 160 m.p.h., breaking the 11 year old record of 141 m.p.h. Recognizing the capabilities of this boat and the possibility of still further improvements of design in a model to be built, the petitioner sought a contractual arrangement which would include Ted Jones, the designer, and Anchor Jensen, the builder. However, because of disagreement as to technical engineering principles Jones refused to sign an agreement which would include Jensen as a party. On July 17, 1950, an agreement was executed "by and

between American Properties, Inc., (and/or S. S. Sayres) Party of the First Part, and Ted O. Jones, Party of the Second Part," which provided that whereas the first party had financed construction of Slo-Mo-Shun III and Slo-Mo-Shun IV and whereas second party designed both of those boats and assisted in development, construction, and testing, the parties agreed as follows: The second party agreed to work exclusively for the first party in the design and development of "Gold Cup" and "Unlimited" classes of racing boats during the existence of the contract and a period of one year thereafter; second party agreed not to disclose to others any basic or essential features of design, construction, or development; first party agreed that when constructing racing boats only second party would be employed to design such boats and to supervise construction, and that upon all boats sold by first party, in whom title should always rest, second party would receive a fee of \$5,000 or 10 percent of sale price, whichever was greater, this being in addition to time and material charges such as had been paid in the past; first party agreed that if Slo-Mo-Shun IV should be sold for an amount greater than cost, first party would pay second party 10 percent of actual net profit after taxes, or a flat sum of \$5,000 whichever was greater, in which case second party would, in consideration thereof, design a new "Unlimited" class racing boat for first party at no additional fee; both parties agreed that in event of any sale of plans and designs of "Gold Cup" and "Unlimited" boats, first

party would pay second party a fee of \$2,500 together with traveling expenses and a fee of \$25 per day actually spent in supervising construction. It was provided that the agreement should continue until terminated by written notice of either party, giving 180 days' notice. It was signed by S. S. Sayres as president of American Properties, Inc., and in his individual capacity, and by Jones.

On July 22, 1950, Slo-Mo-Shun IV, driven by Ted Jones, won the Gold Cup race. Following that Jones was approached by others seeking boats of the design of Slo-Mo-Shun IV. Horace Dodge sought to have two boats built, offering \$50,000 per boat. Jones sought approval of the petitioner which was refused.

Slo-Mo-Shun IV, driven by Lou Fageol, won the Harmsworth Trophy on August 2, 1950.

In August 1950, the Seattle-First National Bank loaned American Properties, Inc. \$26,000 to be used in operations in connection with the boats. No collateral was given for the loan.

In February 1951 construction of Slo-Mo-Shun V was commenced for the purpose of entering the 1951 Gold Cup races. The petitioner prevailed upon Jones and Jensen to work together in the construction of the boat. The boat was constructed at the premises of the Jensen Motor Boat Company under the supervision of Jones and with the aid of some of Jensen's boat builders. The boat was completed by the end of July 1951. Jones received \$5,000 for designing Slo-Mo-Shun V in addition to compen-

sation received on an hourly basis for its construction.

Lou Fageol, a wealthy sportsman who was one of the top two or three drivers in the country, drove Slo-Mo-Shun V and won the Gold Cup in 1951.

In 1952 Slo-Mo-Shun IV, driven by Stanley Dollar, a wealthy man of the Stanley Dollar Steamship lines, won the Gold Cup race. Joe Taggart, who has had as much racing experience as Fageol, also drove the Slo-Mo-Shun boats in competition. In 1953 and 1954 either Slo-Mo-Shun IV or Slo-Mo-Shun V won the Gold Cup races. The Slo-Mo-Shun boats have also won the Martini-Rossi Trophy for the fastest heat in a Gold Cup race and the Aaron DeRoy Plaque for the fastest over-all race average. The petitioner's name appears on the Gold Cup as the winner and the various trophies which were won by Slo-Mo-Shun boats were kept at the Seattle Yacht Club. There were no cash prizes in racing these boats.

The petitioner did not himself personally drive any of the boats in closed course competitive races, such as the Gold Cup or the Harmsworth races. He did drive in speed competition, as in 1950 when he broke the world's straightaway speed record.

About November 1, 1951, Ted Jones left Seattle and went east to work as a boat designer for another concern. He thus ceased to operate under the agreement of 1950. No formal notice of termination of the contract was ever given by either party. Because he felt restrained by the contract of 1950, Jones did not, for a number of years, build any

boats for others of the design of the Slo-Mo-Shun boats, although he had many opportunities to do so. However, commencing in January 1954, he did design a number of boats for various individuals throughout the country, employing the design of the Slo-Mo-Shun boats. At the time of the hearing in this case in 1956, there were about 20 boats eligible for competition in the unlimited class, of which all but four were of the basic Slo-Mo-Shun design.

The members of the crew of these boats included highly skilled technicians who worked on the various Slo-Mo-Shun boats in their spare time since they were full time employees of other organizations. None of them was employed by either American Properties, Inc. or American Automobile Company. Jones was compensated for designing the boats and Jensen was paid for his work in building them.

The principal construction work took place at the Jensen Motor Boat Company, but the engine work was done at the premises of American Properties, Inc., then under lease to American Automobile Company, where there was a machine shop for assembling engines. The small hand tools which were used were the properties of American Properties, Inc. Only occasionally was equipment of American Automobile Company used. An electric hoist which was used was not the property of American Automobile Company. Engines and parts were stored at these premises.

All costs of completing and operating Slo-Mo-

Shun IV and the costs of building and operating Slo-Mo-Shun V were borne by the corporation, including the expenses incurred in racing them, such as traveling expenses of the crew to Detroit in 1950.

The building owned by the American Properties, Inc. was located about one and one-half to two miles from the nearest navigable body of water. Slo-Mo-Shun III was moored at a dock at the petitioner's residence on Lake Washington. Later the petitioner constructed another residence on Lake Washington to which he moved in December 1950, and the Slo-Mo-Shun boats were then housed in the boat house at such residence. At times the boats were housed at the Jensen Motor Boat Company, which is on Lake Washington about five miles from the petitioner's new residence.

Greater Seattle, Inc., a nonprofit, publicly subscribed corporation which promoted the annual Seafair and other sporting events, sponsored campaigns to raise money for the operation of the Slo-Mo-Shun boats because of the advantage to Seattle of bringing the Gold Cup race to Seattle. In 1950 the amount contributed by Greater Seattle, Inc. for this purpose was \$6,912.15. This contribution, whether paid to the petitioner in the first instance, or to the corporation, was ultimately received by the corporation to defray part of the expense of operating Slo-Mo-Shun IV. In subsequent years other contributions were also received from Greater Seattle, Inc. through campaigns for public subscription. In sponsoring campaigns for raising money for this purpose, Greater Seattle, Inc. held

the petitioner out as the owner of the boats. Newspaper articles also consistently referred to the petitioner as the owner of the boats. The official programs of the Gold Cup races listed him as the owner.

The petitioner has never sold any of the Slo-Mo-Shun boats or any designs therefor. After Slo-Mo-Shun IV had been constructed some civilian representatives of the Navy Department examined it and observed it in action. There was no subsequent indication that the Navy would be interested.

In its income tax returns for the calendar years 1949 and 1950 the corporation showed its principal business activity as "Real Estate" and "Lessor of Building," respectively. It reported net income of \$8,423.26 in 1949 and a net loss of \$1,561.41 in 1950. Its returns show that it had surplus at December 31, 1949, of \$74,659.49 (of which \$37,497.43 was earned surplus) and at December 31, 1950, surplus of \$71,260.73 (of which \$34,098.67 was earned surplus).

In the calendar year 1949 the corporation expended \$2,155.56 in operation and maintenance of the boats, which it deducted on its corporate tax return as business expenses. The respondent disallowed this amount to the corporation. In addition, the corporation expended \$561.39 as additional boat expense which it did not deduct on the corporate return.

For the calendar year 1950 the corporation expended \$19,300.58 for operation and maintenance of the boats and deducted on its return the amount of

\$12,388.43 (after offsetting the contribution from Greater Seattle, Inc., in the amount of \$6,912.15). In the return there was included \$1,000 as income from endorsement of an oil product. In this situation the respondent considered that there had been claimed a net deduction of \$11,388.43, which he disallowed.

The corporation capitalized on its books and its returns for 1949 and 1950 the amounts expended for construction of the boats and related equipment (including the amount of \$14,690.30 which was paid by the corporation to the petitioner as hereinabove stated). In the 1949 return the balance sheet at the end of the year includes in depreciable capital assets the amount of \$18,609.16 for boats and equipment, but no depreciation was claimed. For 1950 the amount of capitalization of boats and equipment at year end was \$22,323.37 upon which depreciation was allowed in the amount of \$5,830.84, which was disallowed by the respondent. The respondent included as additional income of the individual petitioners all amounts expended by the corporation in connection with the boats. Inasmuch as the individuals were on a fiscal year ending October 31, whereas the corporation was on a calendar year basis, the respondent determined the amounts which had been expended during the taxable years of the individuals. For the fiscal year ended October 31, 1949, the respondent attributed additional income to the individuals in the amount of \$16,401.51, consisting of \$1,149.82 of disallowed corporate expenses to October 31, 1949, \$561.39 repre-

senting additional boat expense paid by the corporation and not deducted on the corporate return, and \$14,690.30 representing the amount paid to the petitioner by the corporation and capitalized on the corporate return. For the fiscal year ended October 31, 1950, the respondent attributed additional income to the individuals in the amount of \$16,595.31, consisting of \$1,005.74 expended by the corporation as boat expenses from November 1, 1949 to December 31, 1949, \$7,956.50 of net expenses from January 1, 1950 to October 31, 1950, and \$7,633.07 expended during the year ended October 31, 1950 and capitalized by the corporation.

On June 29, 1951, the corporation filed a claim for refund of taxes for the year 1949, based upon the carry-back of a claimed net operating loss for 1950. On August 19, 1952, the corporation filed another claim for refund for the year 1949, based upon a claim that it understated its net operating expenses by the amount of \$561.39 referred to hereinabove.

The activities of the petitioner and the corporation during the years in question with respect to the boats were not conducted with the intention of making a profit. Such activities did not constitute the conduct of a trade or business by either the petitioner or the corporation.

Salary Issues

Jen-Cel-Lite Corporation. The petitioner was employed in some undisclosed capacity by the Jen-Cel-Lite Corporation. At a meeting of the board of

directors of that corporation on November 19, 1949, his salary was fixed at \$4,000 for the period July 1, 1949 to November 30, 1949, and at \$800 per month thereafter. The Jen-Cel-Lite Corporation operated on the basis of a fiscal year ending November 30th. In the joint return of the individual petitioners for their taxable year ending October 31, 1950, there was included salary from Jen-Cel-Lite Corporation in the amount of \$9,600, this being at the rate of \$800 per month for 12 months. The amount which properly should have been included as taxable income by the individuals in the return for the year ending October 31, 1950, is \$12,800. The respondent increased the reported income to \$12,800 and determined an addition to tax for that year under authority of section 293(a) on account of the omission of the \$3,200.

The return in question was prepared by a public accounting firm. It was Sayres' practice to furnish such firm with information as to deductions and interest and donations, and income items such as dividends. The accounting firm also audited the books and prepared the returns of American Automobile Company and Jen-Cel-Lite Corporation. The error of the accounting firm in failing to include the proper amount of salary from Jen-Cel-Lite Corporation was due to confusion resulting from the different fiscal years of the corporation and of the individual petitioners. The petitioner was unaware of this omission until it was brought to his attention by the accounting firm after the revenue agent had discovered the omission and called it to the atten-

tion of the accounting firm. The part of the deficiency for the taxable year of the individual petitioners ended October 31, 1950 which is attributable to the omission from the joint return of the \$3,200 of salary income is due to negligence within the meaning of section 293(a) of the Internal Revenue Code of 1939.

American Automobile Company. The American Automobile Company operated on the basis of a fiscal year ending April 30th. At a meeting of the board of directors of that corporation held on April 23, 1948, the petitioner's salary as president was fixed at \$42,000 "for the year ending April 30th, 1948." The petitioner's annual salary had previously been \$30,000, which had been credited at the rate of \$2,500 monthly. An entry was made on the books of the corporation on April 30, 1948, crediting the petitioner with an amount of \$12,000 to reflect the increase in salary for that fiscal year of the corporation. That entry was never reversed and the corporation included this amount in its deduction for salaries. The corporation withheld tax on a total of \$48,000 and the individual petitioners took credit on their returns for their fiscal year ended October 31, 1948 of the full amount withheld. Such salary of \$42,000 was continued through the succeeding fiscal year of the corporation.

The proper amount of Sayres' taxable salary from American Automobile Company for his fiscal year ended October 31, 1948 was \$48,000, consisting of \$15,000 originally credited for the first six months of his fiscal year, \$21,000 credited to him at

the higher rate for the last six months of his fiscal year, and the amount of \$12,000 credited to him on the books of the corporation on April 30, 1948, representing a retroactive increase in salary for the corporation's fiscal year ended April 30, 1948.

In their separate income tax returns for their fiscal year ending October 31, 1948, each individual petitioner reported the salary from American Automobile Company at \$42,000 and each reported \$21,000 as community income. Each of these returns was prepared by the public accounting firm which customarily prepared the returns of the individuals. The accounting firm committed error in including the incorrect amount in each return. Its error was due to failure to recognize the effect of the different taxable years of the corporation and the individual petitioners. The individual petitioners were not aware of any error in their returns in this respect until the public accountant advised them at the time of the revenue agent's examination in November 1951.

In determining the deficiency the respondent increased the reported community income of each individual petitioner by the amount of \$3,000 and determined an addition to tax pursuant to section 293(a). The part of the deficiencies for the taxable year of the individual petitioners ended October 31, 1948 which is attributable to the omission from their returns of \$6,000 of salary income is due to negligence within the meaning of section 293(a) of the Internal Revenue Code of 1939.

Opinion

The answers to the questions here presented for decision depend upon whether the activities involving the designing, construction, operation and racing of the speed boats constituted, in the years in controversy, a business of the petitioner American Properties, Inc., or whether they constituted the personal hobby of the petitioner Sayres, sole owner of the corporation. There can be no question that prior to the years in controversy such activities were purely the hobby of the individual. The record is replete with evidence to this effect. He had an insatiable desire for speed, and in his testimony he conceded that racing had been his hobby. Prior to the years in question the business of the corporation consisted of owning and renting a building to the petitioner's other corporation, American Automobile Company, which operated an automobile dealership or agency.

The parties devote much of their argument to the question whether title to the boats was in the petitioner or in the corporation. The evidence shows that at a meeting of the directors of the corporation held on August 31, 1949, the petitioner stated that he was willing to transfer title to Slo-Mo-Shun III to the corporation if the corporation would continue to work out improvements in design and engineering. The minutes recite that it was agreed that it was to the best interest of the corporation to enter this new field and that Sayres was authorized to proceed accordingly. The corporation paid the petitioner \$14,960.30 purportedly as purchase price,

which was the amount that had been expended by the petitioner in the construction of Slo-Mo-Shun III and of partial construction of Slo-Mo-Shun IV. Thereafter it continued to pay all costs of construction and operation of the boats. These facts would tend to indicate that it was the intention to transfer title to Slo-Mo-Shun III and the partially constructed Slo-Mo-Shun IV to the corporation. On the other hand, there is other evidence which tends to indicate that title did not pass. There was no formal document transferring title and the petitioner continued to hold himself out as the owner before the public. He represented himself as the owner of Slo-Mo-Shun IV during the years 1950 and 1951 in his statements made for purposes of county property taxes. Furthermore, he apparently continued to deal with the boats in the same manner as he had theretofore, including mooring or housing them at his private residence. The boats were registered in his name as owner on the records of the American Power Boat Association, and in the official programs of races his name appeared as the owner.

The question of whether title passed is not in itself decisive of the issues presented, but is merely one of the factors involved in the more important question of whether the corporation did enter into a true business venture of exploiting these racing boats for profit. The determination of whether the activities of a taxpayer constitute the carrying on of a trade or business requires an examination of the facts in each case. *Higgins v. Commissioner*, 312

U.S. 212. It has been held that whether an enterprise is conducted as a business for profit is a matter of intention and good faith, and all the facts in a particular case are to be considered. *Commissioner v. Field* (C.A. 2), 67 F. 2d 876, affirming 26 B.T.A. 116. See also *Doggett v. Burnet* (C.A.D.C.), 65 F. 2d 191; *Thacher v. Lowe*, 288 Fed. 994; *Edwin S. George*, 22 B.T.A. 189.

Thus, the issues in the final analysis turn upon the question of whether during the years in question the petitioner and the corporation had the requisite intent or motive of making a profit. Intention is a question of fact to be determined not only from the direct testimony as to intent, but from a consideration of all the evidence, including the conduct of the parties. The statement of an interested party of his intention and purpose is not necessarily conclusive. *Helvering v. National Grocery Co.*, 304 U.S. 282, affirming 35 B.T.A. 163. In *R. L. Blaffer & Co.*, 37 B.T.A. 851, *affd.* (C.A. 5), 103 F. 2d 487, *cert. denied* 308 U.S. 576, we stated that one's categorical statement may be of less weight than the facts and circumstances which affect it and that "To be skeptical of the weight to be accorded an interested witness' statement in view of other evidence is not the same as wholly to reject the statement as if it were dishonest."

The petitioner testified that while watching the Gold Cup races at Detroit in 1948, he, Jensen and Jones conceived the idea that there might be a profit in the designing, construction, and sale of racing boats. Thereafter he discussed the possibilities

with his banker and financial adviser, his attorney, and his accountant and they all agreed that there were profit possibilities, and the corporate form was recommended. There was some testimony as to profit possibilities in sale of rights to the design of the boats, but the evidence shows that the boat designs were not patented and the petitioner expressed his belief that they were not patentable. He testified that he constructed Slo-Mo-Shun IV and Slo-Mo-Shun V primarily because there was a good business opportunity. His attorney testified that the petitioner entered into the corporate venture with the idea of its being a profit enterprise. The petitioner testified that the further they went in the development of these boats the more convinced he became that there could be a commercial field resulting from revolutionizing hydroplane racing boats. He stated that the most startling way to do that would be to break the straightaway record that Sir Malcolm Campbell had held for 11 years.

While we do not doubt that the petitioner and others held the belief that there was a profit possibility, we do not believe, in the light of other testimony of the petitioner and others and the conduct of the petitioner, that there was an intention or motive of immediately embarking upon a business venture. Rather, we believe that the parties had in mind merely the possibility of entering into a commercial venture at some future time when it might be deemed expedient to do so. The evidence shows that this never did eventuate.

The minutes of the meeting of the directors of

the corporation held on August 31, 1949, state that the corporation was to proceed "with the end in view of when the time was propitious getting into commercial operation." This left the intended time of actually entering into business in an uncertain state. Actually no boats were ever produced except the particular racing boats Slo-Mo-Shun IV and Slo-Mo-Shun V, which were not intended for sale but rather to be entered in the Gold Cup races with a view to winning those races, and there is no showing of any attempts to sell any boats, to build any for sale, to build any on a fee basis, or to sell any plans or designs for boats. It is contended that testing and proving the boats was a necessary preliminary step in the business of building and sale of boats. However, despite the fact that Slo-Mo-Shun IV did establish a new world speed record in June 1950 and did win the Gold Cup in July of that year, the corporation, which had no boat-building facilities and had no continuing contract with Jensen for building, did not proceed to provide boat-building facilities or take the ordinary steps which might be expected of a business organization looking toward making a profit, such as advertising or making other selling attempts. On the contrary, when Slo-Mo-Shun IV won the Gold Cup race, Jones, the designer and driver, was approached by others seeking boats of this design and one person offered large prices for two boats, but when Jones relayed these offers to the petitioner the latter told him "That we wouldn't be building for anyone." Jones gathered from the

conversation with the petitioner that the reason was that the petitioner did not want any competition from other boats of the Slo-Mo-Shun design. The petitioner testified that he did not attempt to talk to this prospective purchaser, but that he "wanted somebody to talk directly to me about it." He said that he was not interested in making a profit on the Slo-Mo-Shun IV because if he had sold it in 1950 it would have ended any hope of "going on with the development, continuing development and getting into the boat business." He admitted that he had stated for publication in newspapers that he would not sell unless he had another boat ready for competition for the Gold Cup, this being necessary because if he failed to defend the Cup it would move out of Seattle and he would be unpopular in the area. We note that according to Jones' testimony the prospective purchaser did not desire to buy Slo-Mo-Shun IV, but wanted to have two similar boats built, at what Jones stated was a good price. Jones further testified in effect that the reason no other boats were built after Slo-Mo-Shun V was because that particular boat sufficed for the 1951 racing season and that the petitioner did not suggest the building of any further boats.

It would seem that a "propitious" time for actively going into production and sale would have been in 1950 after winning the Gold Cup race. The petitioner's refusal to proceed at that time is certainly not consistent with the claim that he was interested in profit. On the contrary, it indicates

a continuation of the hobby for his personal pleasure and satisfaction. In August, 1951, the corporation borrowed \$26,000 to be used in connection with the boats, but this was after his refusal of offers to buy boats and cannot be considered as indicating a profit motive.

About November 1, 1951, Jones left Seattle and went to work for a boat designer in the east. In January, 1954, he commenced building boats of the Slo-Mo-Shun design for various individuals. The petitioner testified that Jones' departure was the reason that the originally conceived idea of producing racing boats did not ultimately materialize on a commercial basis. No reason is given for his departure and we think it is indicative that he was convinced that there would be no commercialization of the boats.

It is also noted that the operation of the Slo-Mo-Shun boats and expenses of their competition were financed in substantial amount by public contributions through the civic organization, Greater Seattle, Inc. We seriously doubt that a man of the community standing of the petitioner would have permitted these public subscriptions on the public understanding that the operation of the Slo-Mo-Shun boats was a nonprofit hobby if such had not been the case. At various times the petitioner in interviews with the press referred to himself as the owner of the boats and referred to his activities as his hobby. In letters which he addressed in 1953 to a newspaper editorial writer in response

to an editorial concerning him and his boating activities, the petitioner stated that he had personally spent more than \$100,000 in building and developing the Slo-Mo-Shuns, and that no tax adviser had yet been able to tell him how to deduct these very substantial sums for either business or personal income tax purposes.

Upon a full consideration of all the evidence, we are constrained to the view that during the years in question the activities of the petitioner and the corporation with respect to the boats were not conducted with the intention of making a profit and that such activities did not constitute the conduct of a trade or business by either the petitioner or the corporation, and we have so found as a fact. There have been a number of cases, some of which are referred to hereinabove, involving activities which partook to some extent of the nature of hobbies (such as farming, horse racing, horse breeding, dog raising, etc.) which were held to constitute businesses justifying the deduction of losses for tax purposes. However, such cases are distinguishable in that in each the taxpayer had definitely embarked upon business activities with intent to make a profit. In none of them did the taxpayer merely have in mind the thought of possibly engaging in business activities for profit at some future time, as is true in the instant case.

We hold that the corporation is not entitled to deduct the cost of maintenance and operation of the boats under section 23(a)(1) of the Internal

Revenue Code of 1939, as ordinary and necessary expenses paid or incurred in carrying on a trade or business and that it is not entitled to deductions for depreciation on the boats, irrespective of whether title to the boats was in the corporation, since section 23(1) requires, as a condition to such depreciation deductions, that the property be used in a trade or business.

The respondent has held that the amounts paid by the corporation for construction, operation, and maintenance of the boats, including the amount paid to the petitioner in reimbursement of his previously incurred expenditures, are taxable income to the individual petitioners. The respondent in so holding did not limit himself to the theory of constructive receipt of dividends and on brief states that these expenditures constitute a diversion of corporate funds by the dominant stockholder for his personal benefit and as such constitute additional income to him, citing *Davis vs. United States* (C.A. 6), 226 F. 2d 331, cert. denied 350 U.S. 965. We have hereinabove held that the expenditures were not incident to a business carried on by the corporation. We are satisfied that, irrespective of whether title to the boats was in the petitioner, such expenditures were made for his personal pleasure or to gratify his personal or civic pride in the accomplishments of these racing boats. The respondent's determination that these amounts are taxable to the individuals is *prima facie* correct and the petitioners have not shown error in his determination. It is well settled that payments made

by a corporation on behalf of its stockholder may constitute taxable dividends to the stockholder. *Louis Greenspon*, 23 T.C. 138, *affd.* on this issue (C.A. 8), 229 F. 2d 947; *Oreste Casale*, 26 T.C. 1020, on appeal (C.A. 2); *Paramount-Richards Theatres, Inc. vs. Commissioner* (C.A. 5), 153 F. 2d 602. The petitioners have not shown that there were not earnings and profits available in the corporation out of which the amounts in question could be paid and be properly treated as taxable dividends. The corporate returns indicate that there were sufficient earnings and profits available. The respondent's determination that the amounts in question are taxable to the individual petitioners is approved.

The petitioners contend, alternatively, that if the corporation was not engaged in the business then they were, and that the amounts, if taxable to them, would also be deductible by them. As stated above, we think that neither the corporation nor the individual petitioners was engaged in the business. Rather, the expenditures were in furtherance of the private hobby of the petitioner Sayres and as such may not be deducted in view of the provisions of section 24(a)(1) of the Internal Revenue Code of 1939.

The individual petitioners concede that the respondent properly increased their reported taxable income from salary of *Jen-Cel-Lite Corporation* by the amount of \$3,200 for their fiscal year ending October 31, 1950. However, they dispute the de-

termination of an addition to tax under section 293(a) of the Internal Revenue Code of 1939.²

They contest the respondent's determination that for their fiscal year ending October 31, 1948, they had additional salary income from American Automobile Company in the amount of \$6,000, and also contest the determination of an addition to tax for that fiscal year under section 293(a).

The petitioner Sayres testified and contends that it was not intended that his increase in salary voted by American Automobile Company on April 23, 1948 was to be retroactive to the beginning of the corporation's fiscal year which began on May 1, 1947, but that it was intended that it should be prospective commencing May 1, 1948. If this were true then the increase of \$1,000 per month would result in the receipt of taxable salary by him of only \$36,000 for his fiscal year ending October 31, 1948. However, for that year there was reported by the individual petitioners in their returns the amount of \$42,000 as salary. We have carefully examined the resolution passed by the directors of the corpo-

² Sec. 293. Additions to the Tax In Case of Deficiency.

(a) Negligence.—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272(i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

ration and we do not find it ambiguous to any extent. It clearly increased the petitioner's salary to \$42,000 "for the year ending April 30th, 1948." Furthermore, the petitioner was credited on the books of the corporation with an amount of \$12,000 to reflect the increase for that fiscal year of the corporation. It is true that some portion of the \$12,000 related to a period prior to the commencement of the petitioner's fiscal year ended October 31, 1948, but nevertheless such full sum of \$12,000 first became available to him in his fiscal year ended October 31, 1948 and must be treated as taxable income to him in that year. Even though there may have been some misunderstanding as to when the increase should commence, the fact is that the petitioner was actually credited with the \$12,000, no correction was ever made, and the corporation deducted such full amount. Upon the record we have concluded that \$48,000 was the proper amount of taxable salary of the petitioner from American Automobile Company for his fiscal year ended October 31, 1948. We approve the respondent's determination in this respect.

The individuals contend that they should not be held liable for an addition to tax under section 293(a) because of the fact that they were not aware of any omissions from their returns until 1951 when the revenue agent discovered the errors, and that they relied upon an accounting firm to obtain the proper information as to salary from the two corporations. They also state that the errors of the accounting firm in failing to determine the proper

amount of salary income were not unreasonable but are understandable because of the confusion arising by virtue of the difference between the fiscal years of the corporations and of the petitioners. The point is also made that the individuals, and also the accountants, would not be put on notice of omissions by an examination of the W-2 forms furnished by the corporations because of the fact that on such forms the data was submitted on the basis of a different time period.

There is no question here as to the good faith of the petitioners. Wholly aside from the question of good faith, a taxpayer may be guilty of negligence requiring the imposition of an addition to tax on account of negligence. *Evans v. Commissioner* (C.A. 8), 235 F. 2d 586, affirming a memorandum opinion of this Court, cert. denied 352 U.S. 909. It is well established that the duty of filing accurate returns cannot be avoided by placing responsibility upon an agent. *Vern W. Bailey*, 21 T.C. 678; *Harold B. Franklin*, 34 B.T.A. 927; *Irving Fisher*, 30 B.T.A. 433. And we have held that taxpayers must bear the responsibility for the failure of their agents, *Hyman B. Stone*, 22 T.C. 893.

Here it is admitted that \$3,200 in salary from Jen-Cel-Lite Corporation was erroneously omitted, and we have held that \$6,000 of salary from American Automobile Company was erroneously omitted. The petitioners now contend that the increase in salary voted by American Automobile Company was not intended to be retroactive, but the facts are that Sayres was credited with the full amount of

\$48,000 on the books of the corporation, that the corporation deducted such amount and withheld tax on that amount, and that the individual petitioners took credit for such withholding. Furthermore, in their separate returns they did return a total of \$42,000 which includes \$6,000 in excess of what they should have returned had the increase not been retroactive.

The fact that the individual petitioners and the corporations operated upon the basis of different taxable years is not a valid excuse for the failure to exercise due diligence. This situation is not unusual. Accountants preparing returns encounter it frequently. Here the accounting firm certainly knew about the different fiscal years since it audited the books of the corporations and prepared the returns of both the corporations and the individuals. There should have been such an investigation made either by the petitioners or by the accounting firm as would have disclosed the correct amount of salary received by the petitioner or credited to him in his fiscal years which are in question. This was not done. One of the members of the accounting firm testified that the particular accountant, now deceased, who was handling this matter failed to consult the audit papers and that he did not reconcile the deductions taken by the corporations for salaries with the personal returns of the individuals. He further testified that the accountant did not go to the files of the American Automobile Company to see what amounts had been credited to Sayres and therefore overlooked the credit of \$12,000 on the

books of that company. He stated that unquestionably a mistake was made and that it came to light only when the revenue agent made his examination. He also stated that Sayres was of the opinion that there was negligence in the accounting office, that these items should have been discovered, and that the accountant did not do what he should have done.

Under these circumstances we have concluded and have found as a fact that the portions of the deficiencies due to omissions of salary income were due to negligence within the meaning of section 293(a).

The cases of R. E. Nelson, 19 T.C. 575 and Rhett W. Woody, 19 T.C. 350, cited by the petitioners, are not analogous. In those cases the deficiencies were not due to negligence. They were due to the erroneous tax treatment of certain items, but the taxpayers had acted in good faith in reliance on the advice of accountants who were conversant with tax matters and who were fully apprised of the facts.

The respondent's determinations of additions to the tax under section 293(a) are approved.

Decisions will be entered under Rule 50.

Served and Entered September 3, 1957.

Tax Court of the United States
Washington

Docket No. 57748

AMERICAN PROPERTIES, INC., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed August 30, 1957, the respondent herein, on December 20, 1957, filed a recomputation for entry of decision. Hearing was had thereon on February 12, 1958, at which time the recomputation filed by the respondent was not contested by the petitioner. The premises considered, it is

Ordered and Decided: That there are deficiencies in income tax for the taxable years 1949 and 1950 in the respective amounts of \$495.78 and \$3,601.31.

[Seal] /s/ CRAIG S. ATKINS,
Judge.

Served and Entered February 14, 1958.

Tax Court of the United States
Washington

Docket No. 57751

ESTATE OF STANLEY S. SAYRES, Deceased,
Harold L. Scott and A. R. Munger, Executors,
and Madeleine A. Sayres, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed August 30, 1957, the respondent herein, on December 20, 1957, filed a recomputation for entry of decision. Hearing was had thereon on February 12, 1958, at which time the recomputation filed by the respondent was not contested by the petitioners. The premises considered, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year ended October 31, 1949, in the amount of \$10,400.69, and that there are deficiencies in income tax and in addition to tax under section 293(a) of the Internal Revenue Code of 1939, for the taxable year ended October 31, 1950, in the respective amounts of \$12,830.51 and \$641.53.

[Seal] /s/ CRAIG S. ATKINS,
Judge.

Served and Entered February 14, 1958.

United States Court of Appeals
For the Ninth Circuit

Tax Court Docket Nos. 57748 and 57751

AMERICAN PROPERTIES, INC., and the
ESTATE OF STANLEY S. SAYRES, De-
ceased, HAROLD L. SCOTT, and A. R.
MUNGER, Executors, and MADELEINE A.
SAYRES, Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States
Court of Appeals for the Ninth Circuit:

Comes now American Properties, Inc., and the
Estate of Stanley S. Sayres, Deceased, Harold L.
Scott and A. R. Munger, Executors, and Madeleine
A. Sayres, Petitioners on Review herein, by their
attorney, Kenneth P. Short, and respectfully show:

I.

That the above captioned causes bearing Tax
Court Docket Nos. 57748 and 57751, being consoli-
dated causes (with which were also consolidated
causes numbered 57749 and 57750 from which no
review is sought herein), were heard in the Tax
Court of the United States before the Honorable
Craig S. Atkins, Judge, sitting in Seattle, Washing-
ton, on May 18 and 21, 1956.

II.

An order and decision in said consolidated causes was entered February 14, 1958.

III.

This controversy involves the following questions:

(a) Did Petitioner, American Properties, Inc., enter into and carry on a racing boat venture with a profit motive in the calendar years 1949 and 1950, thereby incurring ordinary and necessary expense in the maintenance, operation and depreciation of said boat?

(b) If the answer to (a), *supra*, is "No", then were the amounts so expended by said corporation taxable income to the sole stockholders, Stanley S. Sayres and Madeleine A. Sayres?

(c) If the answer to (b), *supra*, is "Yes", then was the racing boat venture entered into by Mr. and Mrs. Sayres with a profit motive, rendering the expense of maintenance, operation and depreciation deductible?

IV.

Review is sought in the United States Court of Appeals for the Ninth Circuit. American Properties, Inc., is a Washington corporation with its principal place of business at Seattle, Washington. Stanley S. Sayres, during his lifetime, and Madeleine A. Sayres, his wife, were and are citizens and residents of the State of Washington, residing in King County, Seattle, Washington. That Harold L. Scott and A. R. Munger are the duly appointed qualified and acting executors of the Estate of Stan-

ley S. Sayres, Deceased, who died September 17, 1956, and which Estate is in probate in the Superior Court of the State of Washington for King County. That the income tax returns of all petitioners for the years in question were filed in the office of the Collector of Internal Revenue at Tacoma, Washington, within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

/s/ KENNETH P. SHORT,
Attorney for Petitioners on
Review.

Duly Verified.

[Endorsed]: T.C.U.S. Filed May 7, 1958.

[Title of Tax Court and Docket Nos. 57748 and
57751.]

NOTICE OF FILING PETITION FOR REVIEW

To: Chief Counsel, Internal Revenue Service.

You are hereby notified that Petitioners on Review, by their undersigned counsel, did, on the 7th day of May, 1958, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a Petition for Review by the United States Court of Appeals for the Ninth Circuit, of the decision of the Tax Court theretofore rendered in the above-entitled consolidated causes. A true copy of the Petition for Review as filed is hereto attached and served upon you.

Dated this 7th day of May, 1958.

/s/ KENNETH P. SHORT,
Attorney for Petitioners.

Acknowledgment of Service Attached.

[Endorsed]: T.C.U.S. Filed May 7, 1958.

The Tax Court of the United States

Docket No. 57748

American Properties, Inc., Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 57749

Stanley S. Sayres, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 57750

Madeleine A. Sayres, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 57751

Stanley S. Sayres and Madeleine A. Sayres, Petitioners, vs. Commissioner of Internal Revenue, Respondent.

TRANSCRIPT OF PROCEEDINGS

Court of Appeals, U. S. Courthouse, Seattle, Washington, May 18, 1956.

The hearing in the above-entitled matter was convened at 9:30 a.m., before

The Honorable Craig S. Atkins, Presiding.

Appearances: Kenneth B. Short, Esq., and Tracy Griffin, Esq., and Harold L. Scott, Esq., on behalf

of the Petitioner. Gordon M. Cromwell, Esq., on behalf of the Respondent. [2]*

Proceedings

The Court: We will proceed.

The Clerk: Docket 57748, 49, 50 and 51, American Properties, Inc., Stanley S. Sayres and Madeleine A. Sayres.

Will counsel please state their appearances for the record.

Mr. Griffin: Tracy Griffin, attorney for petitioners, accompanied by one of my partners, Mr. Kenneth B. Short.

The Clerk: I believe Mr. Short is not now admitted.

Mr. Griffin: Mr. Short is not now admitted. It developed yesterday that—I am admitted—I have to be a witness. I ask Mr. Short to conduct the interrogation.

The Court: Does Mr. Short intend to make application to be admitted?

Mr. Short: Yes.

Mr. Cromwell: Gordon M. Cromwell for the respondent, your Honor.

The Court: Mr. Griffin, do you care to make an opening statement?

Mr. Griffin: Mr. Short will make the opening statement.

Mr. Short: If it please the court, counsel, there

* Page numbers appearing at top of page of Reporter's Transcript of Record.

are two basic questions presented by these three consolidated cases, two of which are related salary questions, and the first in Docket 57748, American Properties, concerning the Slo-mo-shuns, [4] the so-called racing boats, the property of the taxpayer corporation. Unless there is objection to the contrary I would prefer to proceed on the question of the status of these boats as being either as the government contends, the hobby of Mr. Sayres, or as we contend, the business function of the taxpayer, and when concluded, proceed on these salary questions, which in my opinion, will take from the petitioner's point of view, not over 30 minutes. The Slo-mo-shun question will take, I consider the motion and this array of witnesses that is present are here on that question, and I think for the convenience of them and for the orderliness in general, I would prefer to proceed on that question now.

The Court: I personally see no question.

Does the counsel for the respondent see any objection to that?

Mr. Cromwell: No, your Honor, Respondent has no objection.

Mr. Short: As I indicated, and as the petition doubtless shows——

Mr. Cromwell (interrupting): Maybe I misunderstood Mr. Short. He will put in his entire case on this boat issue before I put in my case on that issue?

Mr. Short: On that issue, yes. And when we have rested this salary question can be disposed of briefly in my opinion. [5]

Mr. Cromwell: That is agreeable, your Honor.

Mr. Short: The question arises as the petition indicates, for the Years 1949 and '50 on the respondent commissioner's review of those returns and assessing to the taxpayer Sayres, which affects both the taxpayer American Properties, Inc., and Sayres, that the acquisition by the corporation from Sayres of the racing boats constituted a constructive dividend, and on the theory that the racing boats were the hobby of Mr. Sayres and, therefore, it followed that if that theory was correct that the expenses in those corporate returns for those years and the depreciation of allowances taken were also improperly there. I think that this case does not involve any dispute in mathematics of figures, that is, if one theory is correct, the government is correct, and if we are correct, the returns are correct.

Getting down to the ultimate question, then, of whether the vessels, racing vessels, are the bauble of Mr. Sayres or whether they are a legitimate business venture of American Properties, Inc., the evidence will show substantially as follows:

That Mr. Sayres has pursued speed since he was a kid, which, in fact, led him into automobiles in his youth, and ultimately into the automobile business, and he has been, for many years, until a month or so ago, principally engaged in the sale of automobiles. In the early 30's, I think it will be 1931, he came to Seattle and acquired a pre-existing corporation called Williams Motors, the name of which he immediately changed to [6] American Properties, who is the taxpayer in this proceeding.

In the early 40's he had developed some fairly startling speeds in racing boats, but in the latter part of 1948 and early 1949 he, in conjunction with Ted Jones, who was then an engineer at Boeing, and Anchor Jensen, who had been in the boat building business, and, his father before him since the beginning of time in Seattle, developed a new design which, in the opinion of Sayres, would revolutionize boat racing, and the idea was conceived that if Sayres, Jones, Jensen, were correct that the existing straightaway speed limit which had existed for 11 or 12 years, could be broken with this new design, that that type of design would be a marketable commodity, not only to the racing fraternity, which is generally centered in the Detroit area, among wealthy persons who can afford to buy an item of that kind, but further, that they would have a market with the Navy as a redesign of the existing PT boat or torpedo launching vessel.

With that in mind, counsel, Mr. Griffin, the financial adviser of Mr. Sayres, A. R. Munger, and the auditor, Mr. Harold Scott, were consulted, and it was concluded that they would organize a corporation for the manufacture and sale of these boats until it was discovered by Mr. Griffin that the William Automobile Company original articles of incorporation included that corporation for that purpose. That being so, the purpose of organizing a separate corporation disappeared, [7] and the existing company, American Properties, Inc., was used for that purpose. That, the evidence will show, was at a time when, that is, the purchase of the

then existing Slo-mo-shun III by the corporation from Sayres, was at a time when Slo-mo-shun IV, which is the new design, the new Jones-Jensen product, was then abuilding, had not yet touched the water. The III was purchased by the company and the IV was completed in 1950, and as predicted by Mr. Sayres——

Mr. Griffin (interrupting): Pardon me, Mr. Short. The Slo-mo-shun IV was completed in October 1949.

Mr. Short: Yes. It first competed in 1950.

Mr. Griffin: That is right.

Mr. Short: As anticipated by Jones-Sayres-Jensen, on January 26, 1950, Mr. Sayres in the Slo-mo-shun IV rendered obsolete every unlimited racing boat in the United States by establishing a record of 160.3235 miles per hour on Lake Washington in the Slo-mo-shun IV.

The Court: What does Slo-mo-shun mean?

Mr. Short: It is a clear misnomer. I have never inquired where that name came from. It is the opposite of what the boat is.

And, therefore, the purpose of the business venture of American Properties, Inc., in going into these vessels was fully justified. The evidence will further show that there came to bear on the construction and operation of these vessels, [8] not only then but in subsequent period, the finest technical and engineering talent that American can produce from the airlines, petroleum companies, engineering personnel and drivers.

It will appear, despite the government's contention that this is a hobby of Mr. Sayres personally, that Mr. Sayres drove the boat on the straightaway speed making records, but he did not drive these vessels in competition. They have won the gold cup, which is a competitive racing award, not a straightaway time or speed award, the silver cup, and the Harmsworth Trophy.

The evidence will further show that Jones, who is the designer—illustrate to you briefly that the departure from normal design in these vessels is that by reason of simple physics and a little bit of aerodynamics when these vessels get underway unlike other vessels they rise out of the water and they ride on the water on two small points on each side of the vessel, and the driving mechanism is in the rear so that all the ordinary water pressure that keeps a boat from going at unlimited speed is out of the vessel, the vessel is out of the water. Jones, who designed this type of thing, and Mr. Jensen disagreed on many things, and the combination of these three people separated them so that in part, that in part, is responsible for the fact that the business venture as such did not go forward. The boat is not ultimately commercially bought and sold. Jones, however, is, or claims to be, the designer of [9] nearly all of the present competitive high speed unlimited class hydroplanes and has built, in accordance with his letter, at least, to the editor of Sports Illustrated, a list of vessels which will race in the coming Sea Fair trophy race which is a \$25,000 prize award race to be held here this coming

summer, and in the Gold Cups which are held traditionally in August.

The total purport of the petitioner's case will be to demonstrate to the court that in its origination and throughout the years in question, although a money-losing venture, it was conceived and originated and proceeded forward on a profit-making theory, and with that intent and purpose in mind, and that from a construction and design point of view, it was about to succeed when the personnel involved departed from the company.

The Court: Mr. Cromwell, do you have a statement to make?

Mr. Cromwell: If the Court please, respondent's position regarding the boat expense disallowed to American Properties, Inc., 1949 and 1950, is that such expenses were not ordinary and necessary business expenses.

The Court: May I interrupt for a moment to ask, is there any stipulation, are some of the facts stipulated?

Mr. Cromwell: None of the facts are stipulated.

The Court: Why is that? Wouldn't it be possible to stipulate some of the facts?

Mr. Cromwell: Several weeks ago we had a meeting, [10] the appellate division, and Mr. Harold Scott was there, and Mr. Griffin, he complained, I had served a subpoena on Mr. Sayres to produce certain books and records, he complained about that, and I told him he could be relieved of that if he could get together and stipulate with me on certain facts, particularly with regard to the salaries,

and he said that he would do that, and I have heard nothing further in that regard.

The Court: Well, of course, our Rule 31 requires of the parties to try and get together and stipulate such facts as are not in controversy, for example, I have been wondering what Mr. Sayres' relation to the corporation is. Is that admitted or stipulated or anything of that sort?

Mr. Cromwell: We will bring that out, your Honor.

Mr. Griffin: May I say, I am of record in this matter, and no approach was made to me at any time on any matter.

The Court: It is the joint responsibility of the counsel. I am very sorry that you weren't able to get together but I see at this stage nothing to do but go ahead.

Mr. Griffin: I was engaged in a trial in Tacoma that was going to last a week, and it lasted three. I got home night before last.

The Court: Well, as we go along there may be certain things you can agree upon.

Mr. Cromwell: In this same regard, your Honor, regarding the expenses, the boat expenses, claimed boat expenses disallowed [11] to American Properties, Inc., in 1949 and 1950, Mr. Short stated, I believe, that there was no dispute regarding the figures, it was just a question of the title of this boat and so forth. It is inherently respondent's determination that the expenses were not ordinary and necessary business expenses, that those matters be

sustained by petitioner, too, or at least, he carry the burden of proof on those matters. We do not agree to those figures. Respondent's position regarding the disallowance of the depreciation deduction on the boats and related equipment claimed by American Properties, Inc., for 1950 is that those assets were not used in the trade or business of the corporation and were not held for the production of income.

There is also at issue in this proceeding dockets concerning the tax years 1949 and 1950 of Mr. and Mrs. Sayres, the amounts of \$16,401.53 for 1949 and \$16,595.61 for 1950, which were added to the income of Stanley and Madeleine Sayres for those tax years. Respondent determined that these sums represented taxable income from the taxpayers' wholly-owned corporation, American Properties, Inc. In referring to the taxpayer I refer to Stanley Sayres, these two amounts are made up in part of expenses disallowed to American Properties, Inc., in 1949 and 1950 for the operation and maintenance of the several racing boats that Stanley Sayres claims were owned and operated by American Properties for business purposes. The balance of those items is made up of amounts of capital expenditures claimed to have been made in 1949 and 1950 on these boats by American Properties.

Now, the corporation is using a calendar year basis for accounting for income. The taxpayers, on the other hand, are using a fiscal year for accounting for their income, the fiscal year ends October 31, so there is an overlapping of expenses, and it is

difficult to understand or explain unless you see the schedule of just how it is broken down.

The Court: You say the individual is on the fiscal year?

Mr. Cromwell: The individual is on the fiscal year, your Honor, ending October 31. So, I have had the technical adviser prepare a schedule showing just the reconciliation of this matter and just how these two approximately \$65,000 items are arrived at. And, if counsel for petitioner will agree, I offer that as an exhibit in aid to the court in following this case.

Mr. Griffin: I think we will agree, subject to checking this so that we don't delay the court.

Mr. Short: I have no objection to that.

The Court: Very well.

Mr. Cromwell: Will you mark this Respondent's Exhibit A.

The Court: It will be received in evidence.

(Respondent's Exhibit Number A [123] was marked for identification and received in evidence.)

Mr. Cromwell: The respondent determined these amounts to be income to Stanley and Madeleine Sayres and, incidentally, I might say that respondent did not limit its determination to constructive dividends; respondent has stated in its statutory notice it was additional income. Respondent determined these amounts to be income to Stanley and Madeleine Sayres on the alternative grounds that, first, title to the Sio-mo-shun was never in American Properties but was in Stanley Sayres and,

second, even if bare legal title was in American Properties, it derived no benefit from the boats, and all the benefits of the maintenance and operation of the boats was innured to Stanley Sayres since, at all times, these boats have been nothing more than his expensive hobby and he has always held them out to the public, also held himself out to the public, as being their owner.

Now, your Honor, Respondent stipulated with petitioner's counsel, Mr. Griffin, that we would agree to excuse one of respondent's witnesses this morning if he would stipulate to an article that appeared in the newspaper under the witness' by-line. The witness is Royal-Brougham.

Mr. Griffin: Yes, I so stipulate, anything under Mr. Brougham's by-line in the Post Intelligencer I will admit he wrote. [14]

Mr. Cromwell: And there is also a quotation in here, Mr. Griffin, I call your attention to, by Mr. Sayres, according to Mr. Brougham, do you admit that he made that?

Mr. Griffin: I don't admit he made that statement.

Mr. Cromwell: Do you admit Mr. Sayres made that statement?

Mr. Griffin: No, I do not, as a matter of fact, I haven't even seen the article. We will have Mr. Sayres here to testify as to whether he made the statement or not.

We also agree to take Mr. Brougham's deposition.

Mr. Cromwell: We also agree to take Mr.

Brougham's deposition, your Honor, in case this proceeding is finished by today. Mr. Brougham will be back by Monday morning, and if we go over, he will be here, but in case he isn't, Mr. Griffin has stipulated with me to take his deposition.

Mr. Griffin: That is correct.

The Court: Very well.

Mr. Cromwell: Respondent's Exhibit B is offered in evidence.

The Court: Very well. It is my understanding now this is merely an admission on the part of counsel for the petitioner that this is an article that appeared, one of Mr. Brougham's articles?

Mr. Cromwell: That is correct, your Honor.

The Court: You do not admit the truth of it or any [15] facts stated in his article?

Mr. Griffin: That is correct.

Mr. Cromwell: For the purposes of the record, your Honor, I would like to state that the article appears in the Seattle Post Intelligencer newspaper, Friday, September 8, 1950, page 14. The article is entitled "The Morning After."

Mr. Griffin: You may not be as familiar with that, that has been Mr. Brougham's column for a great many years in the Post Intelligencer. He is the sports editor.

On counsel's request for a stipulation on the quotation therein which I just now read, I am perfectly willing to stipulate to the entire substance. I wouldn't stipulate to a direct actual quo-

tation, but the entire substance of the quotation I will stipulate is correct, or is factual.

Mr. Cromwell: That is in respondent's Exhibit B, Mr. Griffin?

Mr. Griffin: Yes, I take it you were asking me as you pointed it out to me, "I always like to go fast". Is that what you mean, what Mr. Sayres said?

Mr. Cromwell: I will stipulate that that was made by Mr. Sayres.

Mr. Griffin: It may not be the actual language but the substance, I will stipulate that is the substance.

The Court: Very well, it is so understood.

(Respondent's Exhibit Number B [16] was marked for identification and received in evidence.)

Mr. Short: I will call Mr. Sayres.

STANLEY S. SAYRES

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address?

The Witness: Stanley S. Sayres, 4450 Huntpoint Road, Bellevue. That is my residence address.

Direct Examination

Q. (By Mr. Short): You are the husband of Madeleine Sayres, the other taxpayer in Docket 57751? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. Mr. Sayres, before you came to Seattle, where did you live? A. Pendleton, Oregon.

Q. And when did you come to Seattle?

A. Late in 1931.

Q. What is your present age?

A. Fifty-nine.

Q. When you were in Pendleton what was your business? A. Motor cars.

Q. How did that develop, how did you happen to get into [17] the motor car business?

A. Well, I like motor cars.

Q. And did you enjoy speed?

A. Yes, that is true.

Q. When you came to Seattle did you go into the motor car business here as well? A. Yes.

Q. Did you purchase an existing motor car business? A. Yes.

Q. What was the name of that?

A. I purchased American Automobile Company.

Q. Was there a corporation named Williams Motors? A. Yes.

Q. When did you acquire that?

A. Oh, in the early days after arriving here, but I could not name you the exact date.

Q. And that Williams Motors is the corporation whose name is now American Properties, Inc., is that right? A. Right.

Q. When did you become interested in boats?

A. Well, that was before I came to Seattle.

Q. Before you came to Seattle? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. And did you race boats in or around Pendleton?

A. I did some outboard racing on Coy Lake, which is a [18] small lake six or seven miles out of Pendleton.

Q. Did you continue that when you came to Seattle?

A. No, for several years I was entirely out of it.

Q. Is there, or was there a vessel named Slo-mo-shun I? A. Yes.

Q. Was that yours?

A. That is right, it didn't actually have the "I" on it. We came to numbers later.

Q. Where did that name come from?

A. Mrs. Sayres made that name. I purchased this boat, it was a used one, but it had presumably gone a little over 80 miles an hour with the previous owner, and the day the boat arrived, or the evening, we sat around the dinner table just as you might name a youngster and tossed around possible names. And, she said, "Well, it's supposed to go fast, why don't you call it Slo-mo-shun", and I said, "All right, we will put phonetic spelling on that", and that is the way the name came.

Q. There was, in due course, a Slo-mo-shun II and III, I take it? A. Yes.

Q. And those were speed boats, I take it, were they? A. Yes, racing boats.

Q. The Slo-mo-shun IV and V later developed were of a different design, were they not, than I, II, or III?

(Testimony of Stanley S. Sayres.)

A. Well, they were a progression of those early designs. [19]

Q. And who did the design work on these boats?

A. Ted Jones, that is, I am talking about IV and V now, and III.

Q. And III? A. Yes.

Q. And the construction work was done by whom?

A. Well, III and IV and V were built by Anchor Jensen or Jensen Motor Boat.

Q. Did you see any profit possibilities in III and subsequent boats?

A. Yes, I thought I did.

Q. When did you conceive that notion?

A. Well, after our own experience with the three smaller boats, that is, I, II and III, and after watching the bigger boats run at Detroit on some of the earlier Gold Cup races before we were in competition, it was certainly a unanimous opinion of Jones and Jensen and myself that there was tremendous room for improvement in those boats. As I recall it, the three of us went back to Detroit to watch the 1948 Gold Cup races and look over the boats and so on.

The Court: I don't believe the record shows who these other gentlemen are, except in your opening statement.

Mr. Short: Do you wish them more clearly identified?

The Court: I think so. [20]

Q. (By Mr. Short): Anchor Jensen is whom?

(Testimony of Stanley S. Sayres.)

A. Anchor Jensen is the manager of Jensen Motor Boat Company. That is a local boat-building firm, and he is the man who we say built both the boats. Mr. Jones is the designer of the boats.

Q. He is now, as far as you know, engaged professionally in that pursuit?

A. So far as I know, that is correct.

Q. At the time that you just made reference to in 1948, and for a few years thereafter, he was principally, was he not, an engineer?

A. He was connected with the Boeing Airplane Company.

Q. The Boeing Airplane Company?

A. That is right.

Q. You were in process of relating when you conceived the notion that there would be a profit-making possibility in these boats. I think you have said that in watching the—what, the '48 Gold Cup races?

A. Correct.

Q. Is that when you would say the idea germinated?

A. I think that is as early as you can state it. You cannot say that an idea arrived at 10 o'clock on some particular day.

Q. It is apparent from the, both positions of petitioner and respondent, that the Slo-mo-shun III was acquired by American [21] Properties in 1949. Would you relate what discussions or transactions took place leading up to the acquisition of the Slo-mo-shun III by American Properties from you?

A. Yes. The farther we went along in the de-

(Testimony of Stanley S. Sayres.)

velopment of these boats, the more convinced I became there could be a commercial field, an opportunity, you might say, to revolutionize the hydroplane race boats and what they were doing. And I certainly had in mind that the most startling way to do that would be to smash the straight-away record that Sir Malcolm Campbell held so long.

Q. How long, how long in June, 1950, had the previous record existed?

A. I believe it was 11 years, but without looking up the record, I can't be sure of that.

Q. All right. A. So then——

Q. (Interrupting) May I interrupt you once more before you proceed. When you say that the, in revolutionizing the racing boat field, well, in conceiving a commercial virtue in this revolutionizing the construction of these boats, what do you mean? I mean, what profit motive is there, is it in the construction and sale of the boats?

A. Well, construction or designing, that is, the boat might be designed simply for a fee and somebody else builds it.

Q. But not racing the boats for money, that isn't what you [22] had reference to?

A. There is no money in racing in the Gold Cup races. There never has been. I would like to add that Jones and I were both agreed that there might be another field even more important than just race boats, and that is if the navy should ever want a really high speed, well, what we might call a

(Testimony of Stanley S. Sayres.)

super PT boat. Now, whether the navy is ever going to want one or not, I don't know.

Q. After the acquisition of the Slo-mo-shun III and after the construction of IV, did you ever actually interest the navy in examining these boats?

A. There were some civilian representatives of the navy department came over to the boat house and watched the boat run and examined it. I can't tell you today their names. I don't recall. They spent several hours there.

The Court: May I interrupt, Mr. Short. A few things occur to me for my understanding here.

Now, you and the other two gentlemen were joint owners of the individual boats?

The Witness: No, I was the owner.

The Court: You were the owner?

The Witness: I was the man that put up all the money, and Mr. Jensen was paid for his work in building, and Mr. Jones was compensated for his designing.

The Court: So they had no interest in the design. [23] Was it patented?

The Witness: No, I don't think you can patent it.

Mr. Short: Ultimately I will show that the contract was entered into, if you are wondering how they participated in this.

The Witness: Mr. Jones certainly had a tremendous interest in this.

The Court: Very well, you go ahead.

Q. (By Mr. Short): When I interrupted you to

(Testimony of Stanley S. Sayres.)

bring up these details which you have now furnished us, I had originally asked you, you will recall, what you did to implement this profit, that is, what transactions you had and persons you consulted in reference to it.

A. I discussed it with Mr. Scott, who has always done my tax work, with Mr. Griffin——

Q. (Interrupting) I think you should identify these people. Harold Scott is now, is he not, a partner in Pete, Marwick & Mitchell Company?

A. Yes.

Q. Tracy Griffin is my partner here?

A. Yes.

Q. Any other persons?

A. And Mr. A. R. Munder.

Q. Would you identify who A. R. Munger is?

A. Mr. Munger was an executive of the Seattle First National Bank, and was vice-president and then became president. I don't know the exact date he became president, but I have consulted him on my business affairs from the time I moved to Seattle, and I discussed this very thoroughly with all three of these men.

Q. As a result of that discussion, what transpired, what actually did you do to implement this thought?

A. Well, they agreed that this thing had a profit possibility, and we agreed that certainly it should not be an individual venture. We had to find a place to put it. That meant a new corporation,

(Testimony of Stanley S. Sayres.)

or then, as it occurred to us, we already had one, that was American Properties.

Q. All right.

A. Now do you want me to tell any whys?

Q. No. As I understand the corporation, the present existing corporation, American Properties then went forward and acquired from you Slo-mo-shun III? A. And IV.

Q. And what there was of IV?

A. Yes, it was in a state of construction then. It was not completed.

Q. And that was in that sum of agreed amount, whatever it was, \$140,000? A. Yes. [25]

Q. Who owned, what was the—

Mr. Cromwell (interrupting): Just a moment. You stated that was in the sum of that agreed amount?

Mr. Short: The undisputed amount of what was paid Sayres for the boat.

Mr. Cromwell: That is not undisputed, that is also at issue.

Mr. Short: What is the issue?

Mr. Cromwell: You have the statement and the statutory notice.

The Court: You can furnish proof of that can't you?

Mr. Short: Yes, it will appear. I may say as an aside that it was my conception that the reason the government contended that the expenses were not usual and ordinary was because the boat was the hobby of Mr. Sayres and not because there was

(Testimony of Stanley S. Sayres.)

any dispute that the amounts were expended or that they were expended for the boats.

Mr. Griffin: I thought I heard Mr. Cromwell say in his opening statement that he did not agree to the figures. I understood him to say that he did not agree and I think you understood him to say that he agreed.

Mr. Short: I understood what he said. I will say I was surprised by what he said.

Q. (By Mr. Short): Who in 1949 owned the capital stock in American Properties, [26] Inc.?

A. I did with the exception of qualifying shares.

Q. And do you still own all *by* the qualifying shares? A. Yes.

Q. And that has been continuous?

A. Yes.

Q. When was Slo-mo-shun IV completed?

A. It was launched in October of '49.

Q. And in June, 1950, what occurred in reference to that boat?

A. Well, that is when it established the new world straightaway record.

Q. Of 160 point something. A. 160.

Q. And that was here?

A. Yes, on Lake Washington.

Q. In the perfection and development of it, and construction of the Slo-mo-shun III and IV, did you retain technical help and assistance in the design, construction, maintenance and operation of those vessels?

(Testimony of Stanley S. Sayres.)

A. Well, not so much applying to number III, but after IV was built, very definitely so.

Q. Would you indicate who some of those technical assistants were?

A. Well, going back to the very start of this, Mike Welsh. [27] Mike is from Boeing Airplane Company, a highly skilled technicalman in electronics and certain other fields. We have had at all times two men from Western Gear Works who are experts on gearing, and, of course, Western Gearing designed and built the gear boxes we used.

Q. And they advertise that fact?

A. And we had Elmer Lenin Smith who is still a member of the crew, he now is with Western Gear, but at that time was with the Marine Supply House, we had Anchor Jensen, of course, and naturally Ted Jones, we had a number of other men. The crew has had some changes, but all men that are quite specialized in certain fields.

Q. Have those gentlemen, that is, the key men in that crew, as you call it, become recognized in the United States as being the outstanding people in their respective fields?

A. I think they have.

Q. When these boats are raced in these speeds, I don't mean the straightaway, but in the Gold Cup or the Harmsworth or other trophy races, who drives them?

A. Well, there has been Ted Jones who won the first Gold Cup in 1950——

Q. (Interrupting) You are relating who is driv-

(Testimony of Stanley S. Sayres.)

ing now, is that correct? A. That is right.

Q. All right. [28]

A. Then Lou Fageol won the '51 race.

Q. Who is Lou Fageol?

A. Lou Fageol is one of the oldest and most experienced race boat drivers in the country.

Q. Would you say he is one of the top two or three in the country? A. Oh, yes.

Then, Stanley Dollar of San Francisco won the 1952 race, he was a very experienced driver, had owned his own boats for a good many years and had won the Harmsworth and a number of other important races.

Then, the following year, Joe Taggart began driving on our crew. Joe Taggart is almost an old-timer and as much racing experience as Fageol.

Q. Do I gather from your testimony that you personally do not drive these boats in competitive races? A. That is right.

Q. Gold Cup or Harmsworth races?

A. That is correct.

Q. Is it fair to state, then, that your desire or enthusiasm for speed is not satisfied by driving the Slo-mo-shun IV or V in racing competition, you do not satisfy it in that manner?

A. No, I would like to, but there are some good reasons not to.

Q. And you haven't? [29]

A. I have not.

Q. Other than the original breaking of the

(Testimony of Stanley S. Sayres.)

world record in June 23, 1950, have you driven these boats or either of them competitively?

A. No.

Q. Are these——

A. (Interrupting) You are talking about major closed course competitive race?

Q. Yes. A. Yes.

Q. Speed competition things. You do drive boats? A. Yes.

Q. When the occasion permits? A. Yes.

Q. I started to ask you a question and got away from it. The question I was about to ask you, are these susceptible to pleasure cruises, that is to say, can you take your family in either the IV or V for a boat ride?

A. No, number V only had one seat for the driver, number IV has a mechanic's seat, you can take one passenger in the boat.

Q. You don't take Mrs. Sayres, then, I take it, out on Sunday in these boats?

A. No, it is not a regular procedure.

Q. When you and Jones and Jensen had conceived this thought [30] that the design of the Slo-mo-shun IV was, as it was progressing, might be profitable, did you agree on any terms by which Jones and Jensen might participate in the success of these boats?

Mr. Cromwell: Just a moment, please. Will you specify as to what year they were to become profitable?

Mr. Short: No, I didn't.

Mr. Cromwell: You never did specify that.

(Testimony of Stanley S. Sayres.)

Mr. Short: Your question is, will I specify when that became profitable, my answer is no.

Mr. Cromwell: He has mentioned when he thought it would become profitable, but he has never mentioned a year.

The Court: You mean the year when the thought occurred to him?

Mr. Cromwell: When he thought it would become profitable.

Mr. Short: I misunderstood the question. I thought I asked him that and I thought he said it germinated at the Gold Cup races in 1948.

Q. (By Mr. Short): That would be August?

A. Yes.

Q. When did you get down to these discussions with Munger, Scott and Griffin in reference to actually doing something about it?

A. Those discussions all came along, I am sure, after we [31] had number IV in the water and had begun making our preliminary runs and decided we had a boat that was superior to anything in the picture.

Q. Now, to get back to——

Mr. Short: Will you mark this?

The Clerk: Petitioner's Exhibit 1 for identification.

(Petitioner's Exhibit Number 1 was marked for identification.)

Mr. Short: Will you mark this now?

The Clerk: Two for identification.

(Petitioner's Exhibit Number 2 was marked for identification.)

(Testimony of Stanley S. Sayres.)

The Clerk: And Petitioner's 3 for identification.

(Petitioner's Exhibit Number 3 was marked for identification.)

Mr. Short: I will offer Petitioner's Exhibit 2 for identification, which is a certified copy of the original articles of incorporation of Williams Auto Company, and Petitioner's Exhibit 3 for identification, which is a certified copy of the amendment to those articles simply changing the name to American Properties, Inc.

They are for the purpose of showing that the original articles of the taxpayer corporation authorized the construction and sale of boats and marine engines.

The Court: That would be before this petitioner [32] acquired the company?

Mr. Short: Oh, yes.

Q. (By Mr. Short): You had no interest in Williams Motor Company, or whatever its name was?

A. Yes.

Q. That pre-existed your coming to Seattle.

Mr. Short: Will you mark this?

The Clerk: Four for identification.

(Petitioner's Exhibit Number 4 was marked for identification.)

Mr. Cromwell: I object to this exhibit, Petitioner's Exhibit 2 marked for identification, it hasn't been properly identified, your Honor.

Mr. Short: It is a self-identifying document. The certificate on the back is that of the auditor

(Testimony of Stanley S. Sayres.)

of King County who is the custodian of the document with whom it must be recorded.

The Court: It will be received.

(Petitioner's Exhibit Number 2 was received in evidence.)

Mr. Cromwell: No objection to 3.

Mr. Short: I offer Exhibit 3.

The Court: They will be received.

(Petitioner's Exhibit Number 3 [33] was received in evidence.)

Q. (By Mr. Short): Mr. Sayres, I hand you what has been marked for the clerk as Petitioner's Exhibit 4 and I will ask you to state what that is.

A. Yes, this is a meeting of the Board of Directors of American Properties.

Mr. Cromwell: Just a moment. You have been asked to identify it, not to read from it.

Mr. Short: That is exactly what I expected him to do.

Mr. Cromwell: I thought he was going further, Mr. Short.

Mr. Short: Oh, all right.

Q. (By Mr. Short): What date?

A. August 31, 1949.

Q. And is the signature that purports to be that of S. S. Sayres your signature?

A. That is correct.

Q. And the other signature is whose?

A. Mr. Griffin's, the secretary.

Q. And was there on that date actually a meeting held for that purpose? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. And is that document which you hold in your hand the [34] original minutes of that meeting?

A. Yes, I am sure it is.

Mr. Short: I will offer Petitioner's Exhibit 4.

Mr. Cromwell: No objection.

The Court: It will be received.

(Petitioners' Exhibit Number 4 was received in evidence.)

Q. (By Mr. Short): I had earlier asked you whether or not arrangement or agreement had been arrived at between yourself at any time, between yourself, Ted Jones and Anchor Jensen in reference to the commercial construction of these vessels.

A. There had been a great many discussions.

Q. I hand you what has been marked for identification as Petitioner's Exhibit 1 and I will ask you if you will state what that is.

A. That is an agreement that was signed between American Properties, Ted Jones and myself.

Q. And dated?

A. 17th of July, 1950.

Mr. Cromwell: Who did you state signed this?

The Witness: American Properties, S. S. Sayres as an individual and Ted Jones.

Mr. Cromwell: I have no objection to this except the pencil notation on the first page. [35]

Mr. Short: Well, let me ask him about it.

Q. (By Mr. Short): There appears on the first page of this Petitioner's Exhibit 1 a pencil notation "Unlimited Class", and the pencil nota-

(Testimony of Stanley S. Sayres.)

tion "It was up to 30,000 horsepower". Whose writing is that, "It was up to 30,000 horsepower"?

A. That is mine.

Q. Is it a part of the contract or not?

A. Well, it doesn't affect the contract as I see it. I don't recall now why I put it on.

Mr. Cromwell: When was it put on?

The Witness: I don't know.

Mr. Cromwell: I will agree to the exhibit with the exception of that one pencil notation.

Mr. Short: I think it has no significance.

The Court: It will be ignored, then, the pencil notation.

It will be received.

(Petitioner's Exhibit Number 1 was received in evidence.)

Q. (By Mr. Short): Mr. Sayres, was there any agreement drafted preceding that Exhibit 1?

A. Yes.

Q. That included Anchor Jensen? [36]

A. Yes.

Q. Why was that not signed?

A. Well, a good deal of friction developed between Ted Jones and Anchor Jensen, and it finally reached a point where Ted said he didn't want to be a party in a deal with Anchor.

Q. And that Exhibit 1, then, constitutes a re-draft of that agreement eliminating Jensen?

A. Correct.

Q. One further question. At whose request does S. S. Sayres individually sign that agreement?

(Testimony of Stanley S. Sayres.)

A. That was at Ted's request.

Q. Why?

A. On this particular point, I bound myself on that agreement not to have somebody else build boats for me. The agreement was between American Properties and Jones, but if I hadn't named myself individually——

Mr. Cromwell (interrupting): I object to what the agreement was between, your Honor. It speaks for itself.

Mr. Short: It does not speak for itself, and I am asking the witness to state why, when the title to the vessel and the enterprise is all in a corporation, why an individual binds himself to it.

Mr. Cromwell: I object to that.

The Court: Let him finish.

Mr. Cromwell: Pardon me. [37]

Mr. Short: I am not contradicting the document, I am explaining why S. S. Sayres is an individual signatory to a contract when American Properties at that time owned Slo-mo-shun III and IV.

Mr. Cromwell: That is their assumption, that the corporation owned it. It is not in the record that American Properties owned this boat.

Q. (By Mr. Short): Was there any documentary title on either of the vessels or any of them, I mean, did you ever get a bill of sale or give a bill of sale or any other documentary transfer of either Slo-mo-shun III or IV to American Properties?

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Just a moment. That is not the best evidence, your Honor. The document itself of the transfer of title would be the best evidence.

Mr. Short: Don't you think we ought to find out if there is one? If there isn't any, this is the best evidence.

The Court: Yes.

Q. (By Mr. Short): Was there any?

A. No.

Q. This boat didn't come to you by document, you built it? A. That is right.

Q. There wasn't any document in existence?

A. Yes.

Q. Other than Exhibit 4, the resolution in evidence, was there any other documentation of the fact that the ownership of the boats was then in the corporation?

A. Well, all the billing for the work as it progressed, and all of those——

Mr. Cromwell (interrupting): I think the question calls for a yes or no answer.

A. Well, yes.

Q. (By Mr. Short): The documentation that you refer to are the books and records of the company and the invoices? A. Yes.

Mr. Cromwell: Just a moment. That is a leading question. I move to strike the answer.

The Court: It was a leading question, as you know. I presume that we must abide by the rules.

Mr. Short: I think he had already answered. I was repeating his answer.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: I move to strike his answer, then, your Honor.

The Court: I don't know what good that would do. You can rephrase your question. It will be stricken and rephrase your question. [39]

Q. (By Mr. Short): When you say there is some documentary evidence, is it a fact that the title to the boat is in American Properties, will you state what documentation you refer to?

A. Invoices, checks paid out, probably others that I don't recall right now, that would be the mass of the evidence.

The Court: May I ask a question?

Mr. Short: Yes.

The Court: I don't know very much about boats. Do they have to have a license like a car does, automobile?

Mr. Short: Boats ordinarily do not.

Q. (By Mr. Short): Mr. Sayres, how about these boats?

A. A race boat run on any sanctioned regatta has to be registered with the American Motor Boat Association.

Q. If I own a cruiser, I must have some Coast Guard certificate?

A. Yes, and the Coast Guard has some requirement in the last two years, I believe it is, on the registration of a race boat.

Q. Did it at this time? A. No.

Q. By the way, to the extent that there may be confusion about it, this Exhibit 4, being the resolu-

(Testimony of Stanley S. Sayres.)

tion of American Properties of August 31, 1949, is that the date on which your conception of this thing being a profitable venture actually [40] materialized?

A. That is the date on which we said, "Here we go."

Q. All right. Now, bringing you up to the point of time when Exhibit 1 was signed in July of 1950, you had then just the month previous set the record, hadn't you? A. Yes.

Q. With Slo-mo-shun IV? A. Yes.

Q. What, then, transpired between you and Jones and Mr. Jensen and the American Properties in reference to the program to build and sell either the boats or the design of the boats similar to Slo-mo-shun IV, what historically occurred from then on?

A. Well, we, as I say, that agreement was made purely with Jones, Jensen not a party to it.

Q. Yes.

A. We did decide to go ahead and build Slo-mo-shun number V. Now, if I get out of the field that you want me, stop me.

Q. No, that is all right, that is what I want.

A. And I managed to prevail on Jones, or Jones and Jensen, to try and get along while we were building that boat, and Ted Jones worked right out at Jensen Motor Boat Company and helped construct it. That boat was started in, I believe, February of '51, and put in the water late in July.

After that, in the meantime, Jones had ceased

(Testimony of Stanley S. Sayres.)

to work [41] for Boeing Airplane Company, and sometime later after August, I would profess to say the date, he left Seattle and went to work for Kiekhefer.

Q. I think you better spell that one.

A. I hope I can. That is the builder of Mercury Outboard motors. K-i-e-k-h-e-f-e-r is the best guess I can make out of it.

Q. What is your best recollection of that?

A. Sometime late in 1951, but I wouldn't profess to try and pin it down.

Q. All right. Is that the reason the originally conceived idea of producing these boats did not ultimately materialize on a commercial basis?

A. That is correct. He was gone, I heard nothing from him.

Q. Is he now in the business of commercially designing boats?

A. I would say very much so.

Q. How many, off-hand, in limited class hydroplanes are now in existence, give us an estimate, that actually race?

A. Well, you have got to take into account some new boats that have not yet raced, but will this—

Q. (Interrupting) I mean, including them for this question. A. Let's say 20. [42]

Q. How many of them, also estimating, are of the basic Slo-mo-shun design?

A. To the best of my knowledge, all except three boats owned by Horace Dodge and Miss Pepsi

(Testimony of Stanley S. Sayres.)

owned by Dawson Brothers. I think I am correct in that.

Q. Is it fair to state that your prediction that this would be the design universally used was correct?

A. That has been proven entirely true.

Q. By the way, that agreement, Exhibit 1 in evidence, contemplates the payment to Jones of \$5,000 minimum, I believe it was, per vessel. Did he ever get that payment?

A. He received \$5,000 for the design of number V and was also paid for the hourly work that he put in on the construction.

Q. In addition to the \$5,000? A. Correct.

Q. By the way, I overlooked something. The court, sometime ago, inquired as to, regardless of these articles of incorporation of William Motors and the amendment to American Properties, what actually was the function, what was the regular function of American Properties, Inc., prior to August 31, 1949?

A. It owns the, well, we have always called it the main building at Broadway and Madison.

Q. In which the automobile dealership business is maintained, is that right? A. Right. [43]

Q. It is a landlord corporation? A. Yes.

Q. Or was? A. Yes, still is.

Q. Mr. Sayres, would you tell us whether now or in 1949 and '50 racing speed boats was or is your hobby, of these unlimited class hydroplanes, is that a *personally* hobby to you?

(Testimony of Stanley S. Sayres.)

A. Driving the boats, test-hopping, yes, we will call it a hobby, racing the boats—

Mr. Cromwell (interrupting): That answers the question, your Honor.

The Court: I think the witness wants to explain his answer.

A. Proving those boats by competition was the fundamental that would make a business out of them, by winning races.

Q. (By Mr. Short): Like the Gold Cup Races?

A. Correct.

Q. What does test-hopping mean to you?

A. Oh, experimentation, you are trying one propeller, you are trying this and that, steering gears, skid fins, rudders, that is strictly, you might say, an engineering and development project.

Q. What was the prime thing, or your primary motive or purpose in going into the construction of IV and V? [44]

A. I thought there was a business opportunity there.

Q. Was there? A. Yes.

Mr. Short: That is all.

The Court: Let us take a short recess before cross-examination, ten minutes.

(Short recess taken.)

The Court: On the record.

Mr. Cromwell: Your Honor, to save the time of the court, I have about six or eight tax returns here which I am going to ask if counsel for petitioner

(Testimony of Stanley S. Sayres.)

will agree that they will be put in. In other words, have them identified all at one time.

Mr. Short: Are they all one exhibit?

Mr. Cromwell: No, we will make them different exhibits, Mr. Short. Perhaps it would be simpler to have these marked, your Honor, and have the witness identify the signatures.

The Court: Maybe you can stipulate to them.

Mr. Short: Well, the petitioner will make no objection to the identification of the documents, that they are what they purport to be. I question their materiality at this stage of the proceeding.

Mr. Cromwell: I better have these marked and identified.

The Court: I see no reason for that if counsel recognizes [45] that they are competent.

Mr. Cromwell: That is right, they are taxpayer's returns.

The Court: Which taxpayers?

Mr. Cromwell: His individual tax return of Stanley S. Sayres for the tax year ending October 31, 1948, and the individual income tax return of Madeleine A. Sayres for the taxable year ending October 31, 1948, the individual tax return of Stanley S. and Madeleine A. Sayres for the taxable year ending October 31, 1949, the individual income tax return of Stanley S. and Madeleine A. Sayres for the taxable year ending October 31, 1950.

The Court: I will receive them in evidence for whatever relevance they may have, Mr. Short.

Mr. Short: How are they marked?

(Testimony of Stanley S. Sayres.)

The Clerk: They will be marked C, D and E respectively—C, D, E and F respectively.

(Respondent's Exhibits Numbers C, D, E and F were marked for identification and received in evidence.)

Mr. Short: Are they, Mr. Cromwell, in the order that you—Mr. Cromwell, are they marked in the order that you read them to the court?

The Clerk: Yes, respectively as he submitted them.

Mr. Cromwell: I offer Respondent's Exhibit C, which [46] is the income tax return of Stanley S. Sayres for the year ending October 1, 1949.

The Court: They have been received and marked in the order in which you read them off.

Mr. Cromwell: Will you mark these please?

The Clerk: Exhibits G and H for identification.

(Respondent's Exhibits Numbers G and H were marked for identification.)

Mr. Cromwell: I offer Respondent's Exhibit G in evidence, which is the 1949 corporation income tax return of American Properties, Inc.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit Number G was received in evidence.)

Mr. Cromwell: I offer in evidence Respondent's Exhibit H, which is the 1950 corporation income tax return of American Properties, Inc.

Mr. Short: No objection.

The Court: It will be received.

(Testimony of Stanley S. Sayres.)

(Respondent's Exhibit Number H was received in evidence.) [47]

Cross Examination

Q. (By Mr. Cromwell): Is it correct, Mr. Sayres, that your position is that the boats, Slo-mo-shun III and IV were transferred by you to American Properties sometime in 1949? A. Yes.

Q. Then would it also be a correct statement, Mr. Sayres, to say that these boats were never transferred back to you? A. Yes.

Q. Was ever a bill of sale given to the corporation for the transfer of these boats? A. No.

Q. In other words, it is your position that at no time since 1949 have you held title to either of these boats? A. That is correct.

Q. Would you also say that is true as to Slo-mo-shun V? A. Yes.

The Court: May I ask a question?

Is that also true with regard to the design or whatever else with regard to it might be of value, or are we talking now about the physical boat?

Mr. Cromwell: The physical boat, your Honor.

Q. (By Mr. Cromwell): Would your answer be the same regarding the physical boats Slo-mo-shun III, Slo-mo-shun IV and Slo-mo-shun V?

A. Yes. That is what I was referring to.

The Court: I don't think I got an answer to my question. [48]

Mr. Short: I think, Mr. Sayres, the court is curious as to other than the physical boat, assume

(Testimony of Stanley S. Sayres.)

the design was patentable for example, that is the kind of thing he refers to, who owns that, does the corporation own that?

The Witness: No, Mr. Jones was the designer, I couldn't control what he might do.

Mr. Cromwell: I think the question was asked by Mr. Short if there was a patent or a copyright on those boats.

Mr. Short: The court asked him that.

The Witness: No patent.

Q. (By Mr. Cromwell): And your answer is there is no patent on those boats?

A. That is right.

The Court: What I am concerned about, if it was just the physical boat that the corporation owns, would it have a right to manufacture other boats of the same design and sell them? I don't know whether they have that right under contract with them or not. I haven't read all the papers here yet. Perhaps that is a matter for argument. It may not be a matter of evidence.

Mr. Cromwell: I think so.

The Clerk: Exhibits I and J marked for identification.

(Respondent's Exhibits Numbers I and J were marked for identification.) [49]

Mr. Cromwell: Respondent offers Respondent's Exhibit I as an exhibit, offers it in evidence, your Honor, which is a certified copy of the county assessor's records, which is a declaration made by Mr. Sayres in 1950 to the office of the county assessor

(Testimony of Stanley S. Sayres.)
of King County, Seattle, Washington, as to the
ownership of this boat and its value, Slo-mo-shun
IV.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit Number I was received in evidence.)

Mr. Short: Is there a date on there?

Mr. Cromwell: Here it is.

I offer in evidence Respondent's exhibit marked "J", which is a certified copy of a declaration filed with the county assessor of King County in 1951 signed by Stanley S. Sayres, declaring that he is the owner of Slo-mo-shun IV.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit Number J was received in evidence.)

Q. (By Mr. Cromwell): Mr. Sayres, I show you Respondent's Exhibit I and ask you if you signed that declaration?

Mr. Short: I don't hear you, Mr. Cromwell. [50]

Mr. Cromwell: I am showing Mr. Sayres Respondent's Exhibit I and asking him if he signed the declaration, of which this is a copy.

A. That is my signature.

Q. (By Mr. Cromwell): I hand you Respondent's Exhibit J and ask you if that is your signature on Exhibit J?

A. That is my signature.

Q. Mr. Sayres, you have stated, I believe, that

(Testimony of Stanley S. Sayres.)

Slo-mo-shun IV won the Gold Cup in Detroit in 1950? A. Yes.

Q. And that Mr. Ted Jones was driving the boat at that time? A. Yes.

Q. Was the expense of running the Gold Cup Race in Detroit in 1950 paid by American Properties?

A. Yes. There was later some other funds came in that didn't directly concern the Gold Cup.

Q. Then, you would say that American Properties paid the expenses of running the Gold Cup Races in 1950? A. Yes.

Q. You did not pay them, is that a correct statement?

A. No, that was charged to American Properties. Now, I can't say that I didn't write a personal check somewhere here and there in the proceeding, but the accounting was all made, [51] and it all went to American Properties.

Q. And would you also say, Mr. Sayres, that all costs of building and developing Slo-mo-shuns IV and V were paid by American Properties?

A. Yes, with that exception, that I make there. Here and there I might have doled out \$50 in cash or written an occasional \$50 personal check which then was charged back.

Q. And would you say that the American Properties also paid all of the expenses of operating Slo-mo-shun IV and Slo-mo-shun V? A. Yes.

Q. From 1949 on?

A. All that were not covered by other sources.

(Testimony of Stanley S. Sayres.)

The Court: Are these cases consolidated?

Mr. Cromwell: I think that is one thing we have neglected to do is to move to consolidate these proceedings.

Mr. Short: Yes.

Mr. Cromwell: For hearing and decision, your Honor.

The Court: All right, they will be consolidated for hearing and decision.

Mr. Cromwell: Will you mark this please?

The Clerk: Exhibit K for identification.

(Respondent's Exhibit Number K was marked for identification.)

The Clerk: And L. [52]

(Respondent's Exhibit Number L was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit K for identification which purports to be a letter on the letterhead of Stanley Sayres, Incorporated, dated August 26, 1953, and referring to the last page of that letter, I ask you if that is your signature. A. That is.

Q. And is that letter addressed to Mr. Paul Alexander of the Rainier District Times, Seattle, Washington? A. Yes.

Q. Did you write that letter, Mr. Sayres?

A. I am sure I did.

Q. You did write that letter, Mr. Sayres?

A. Yes.

Mr. Cromwell: I offer Respondent's Exhibit K in evidence.

(Testimony of Stanley S. Sayres.)

Mr. Short: Your Honor, I will have to read the exhibit, I object to the relevance of the exhibit for any purpose.

The Court: For what purpose is it offered?

Mr. Cromwell: As an admission against interest, your Honor.

Mr. Short: In what respect?

Mr. Cromwell: The statement in here, I am not contending [53] to limit my offer, I am offering the whole letter. Mr. Sayres has testified that the American Properties spent the money to build these boats, Slo-mo-shun boats IV and V, and to race these boats in the Gold Cup, and this letter states to the contrary that those expenses were paid entirely by him.

Mr. Short: Where does it state it?

Mr. Cromwell: I will read this, "I should also know that all the costs of running the 1950 Gold Cup Race in Detroit and the 1951 Gold Cup Race in Seattle were paid entirely by me".

The Court: Mr. Short, I think I will have to receive it on the ground that it tends to be a statement against interest.

Mr. Short: Yes.

The Court: You will have the opportunity to get at it on redirect.

(Respondent's Exhibit Number K was received in evidence.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit L marked for identifica-

(Testimony of Stanley S. Sayres.)

tion, which is a letter addressed to Paul A. Alexander, the Rainer District Times, Seattle, Washington, dated September 21, 1953. Turning to page three of that letter, I ask you if that is your signature. A. Yes, that is the same one.

Q. No, it is not.

A. That is my signature. [54]

Q. This is your signature, Mr. Sayres?

A. Yes.

Q. And did you write this letter, Mr. Sayres?

A. Yes.

Mr. Cromwell: I offer in evidence Respondent's Exhibit L, which is the letter of Stanley Sayres dated September 21, 1953, to Mr. Paul J. Alexander, Rainer District Times.

Mr. Short: I have obviously the same objection because it is a redraft of the same letter, is it not, counsel?

Mr. Cromwell: No, it is not. This is a different letter.

Mr. Short: Same objection, and particularly to the volunteer underlining in red of certain words that have not been identified.

Mr. Cromwell: The underlining in red, Mr. Short, was not done by the government. That was in the letter.

The Court: Is it necessary for me to read this one? Does counsel agree that it is in general like the other letter?

Mr. Short: Yes, it would serve no purpose to read it again.

(Testimony of Stanley S. Sayres.)

The Court: I will admit it as I did the other one, with opportunity for you on redirect to explain the letter.

(Respondent's Exhibit Number L was received in evidence.)

Mr. Cromwell: Will you mark this please? [55]

(Respondent's Exhibit Number M was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit M marked for identification, which purports to be a copy of the Rainer District Times dated Thursday, August 20, 1953, and I refer you to an editorial there by Mr. Paul J. Alexander, and ask you if you read that editorial.

A. Yes.

Q. You have seen that? A. Yes.

Q. Would you state that was what precipitated these letters just put in evidence?

A. Yes, correct.

Q. To Mr. Alexander? A. That is correct.

Mr. Cromwell: I offer Respondent's Exhibit M in evidence, your Honor.

Mr. Short: Well, I will object to the editorial, having read the first of these letters in response to this editorial, the thing was claimed to be libelous. It affects no issue in the matter before the court. It protests the littering of Lake Washington as a result of Gold Cup Races, and that this witness is the culprit. There is no reference to these expenses paid by either the corporation or Mr. Sayres.

Mr. Cromwell: Your Honor, it is offered simply

(Testimony of Stanley S. Sayres.)

to tie it in with the letter. Mr. Sayres has stated it was what caused him to write the letters, this editorial. It is not offered as evidence of the facts therein stated.

Mr. Short: I may add that it is an attempt to add to the government's case because of the fact the views of Mr. Alexander coincided with those of the government that this is a wealthy industrial-playboy. That is the purpose of the offer, and that is all that appears in the editorial.

Mr. Cromwell: The purpose of the offer, your Honor, is just to show the occasion for these letters.

Mr. Short: What purpose is served by proving the occasion? The purpose of the letter is a statement against interest, proving the occasion for the letter is simply inflammatory.

The Court: I don't think we ought to have this in evidence, Mr. Cromwell.

Mr. Cromwell: Your Honor, I don't see how you can understand those letters unless you have this to tie them in. It is not offered as any fact.

The Court: The only thing the letters are in for is to show certain statements made by the petitioner here that he stood the expenses of large amounts. I don't know that——

Mr. Cromwell (interrupting): Those letters, your Honor, are offered for all purposes, they are not limited to [57] that.

Mr. Short: They only have one valid purpose and that is the one I inquired about.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Respondent has offered them for all purposes, and I believe the court has received them as general statements.

Mr. Short: They are objectionable for all purposes, they are admissible for one, the statement against interest.

The Court: I don't think they are admissible for any purpose except the admission against interest.

Mr. Cromwell: That is right, but the entire letter is offered.

The Court: Is there anything else in those letters other than the statement about paying personally these expenses of the races and the boat?

Mr. Cromwell: And the matters as he personally stated here, "Now to get a few more facts on the record: One, I have personally spent more than \$100,000 in building and developing the Slo-mo-shuns—" I will skip two, I will skip down to four, "No tax advisor has yet been able to tell me how to deduct these very substantial sums from either business or personal income taxes".

Now, that is certainly relevant, your Honor.

Mr. Short: Those are the two remarks in the entire four-page letter which have any relevance here. [58]

Mr. Cromwell: Your Honor, Number seven also states, "Your reference to 'well-to-do' seems sarcastic. I have had some reasonable degree of success in 35 years in business. I do not, however, have so much money that I can personally afford to finance

(Testimony of Stanley S. Sayres.)

Seattle's greatest show to the tune of thirty to thirty-five thousand dollars per year".

Mr. Short: That is not a statement of any relevance to this proceeding. It is not against interest.

The Court: Can't counsel stipulate that those letters were written in answer to an editorial in the paper?

Mr. Short: I may——

The Court (interrupting): You might even state in substance what this is.

Mr. Short: I will stipulate that Exhibit K and L are written in response to that editorial, but the editorial itself has no bearing.

The Court: I don't see how this has any evidential value, this paper itself. As you say, it only explains why this man wrote the letters. Why couldn't you simply stipulate to this, that they were written in answer to an editorial criticizing—well, whatever the substance of that is?

Mr. Short: I reserve my objection to the editorial.

Mr. Cromwell: I would like to make an offer of proof on this editorial, read it in the record.

Respondent's Exhibit marked "M" for identification, if [59] received, would show that in the Rainer District Times dated Thursday, August 20, 1953, on the left-hand far extreme side of the first page under an editorial entitled "Our Opinion" by Paul J. Alexander, I quote from that:

"Tears as large as grapefruit rolled down our cheeks last Sunday morning when we read of the

(Testimony of Stanley S. Sayres.)

appeal for help to raise \$37,500 to aid a well-to-do automobile distributor in this city to carry on his favorite, rather expensive hobby, of racing unlimited hydroplanes. If we recollect correctly, there was some \$45,000 raised last year to send these hydroplanes back to race for the Harmsworth Trophy. They never went. We thought of the thousands of dollars it has cost the taxpayers already to prepare for and clean up the mess which attended the recent hobby show on the shores of Lake Washington. With so much money need for worthy causes such as the fight against cancer, heart disease, cerebral palsy and the forthcoming Good Neighbors Drive, we see the public fund raising for pet racing hobbies as a little far-fetched. Sometime ago it was suggested that members of civic boards such as the Park Planning, Library and School Boards be reimbursed for their expenses in connection with the giving of their time and energies for the good of the community. Our mayor vetoed this idea orally declaring that the honor was sufficient recompense for the work, thought and expense involved. Now it seems to us that if a public collection is to be taken up it should go adding to the funds necessary to [60] provide our departments help to clean up the messes incident to the carrying on of the combination, advertising hobby of our well-to-do citizens.

Seems that we can recall quite a fuss raised by some members of the City Council a year ago when S. L. Savage, an automobile dealer, wanted to

(Testimony of Stanley S. Sayres.)

donate a pair of giraffes to our city. These he had captured at his own expense and the beef was about providing housing for them. Our big brother, TPI, would do well to stick by such fine promotions as they have sponsored for the past several years, such as teaching our youngsters how to swim, aiding the music under the stars, and other like splendid civic contributions. Every time they come up with something that has to do with the Gold Cup Races they raise the eyebrows of those who like our Seward Park unscalped and our beaches free of beer cans, milk bottles, watermelon rinds and other debris.”

The Court: Very well, the objection is sustained. I think that just newspaper articles or editorials are not competent proof in this case.

(Respondent's Exhibit Number M was rejected.)

Q. (By Mr. Cromwell): Mr. Sayres, when did you become the principal stockholder of American Automobile Company?

A. January—oh, principal, I believe in '37. [61]

Q. How many shares of stock do you hold, or did you acquire, at that time?

A. I don't recall the number of shares. I had one major partner, Mr. Luke Wood, I bought him out, I believe it was in the, oh, late in '37, and I bought whatever he had outside of a qualifying share or two.

Q. What has been the business of American Properties since it was incorporated—pardon me, American Automobile Company?

(Testimony of Stanley S. Sayres.)

A. Merchandising motor cars and parts.

Q. What type of automobiles?

A. Chrysler-Plymouth.

Q. Do you consider that it was a retail distributor or just what?

A. Well, we were a distributor in the full sense of the word from '32 through, I believe it was '47, and then the Chrysler corporation wiped out all distribution and we became a direct dealer.

Q. That is in King County?

A. They wiped it out from one end of this country to the other. We became just one of other Chrysler dealers in King County.

Q. In King County in which Seattle is located?

A. Right.

Q. Do you know how many others during the years 1949 and 1950, how many other Chrysler dealers there were? [62]

A. Well, I hesitate to make a flat statement. I think there were six in the county and I think there were two others within the city limits, and one on Mercer Island. I am not flatly positive of that county, the numbers change now and then.

Q. Who owns the building occupied by the American Automobile Company?

A. American Properties.

Q. And do you also own American Properties Corporation? A. Yes.

Q. You are the sole stockholder, is that correct, other than qualifying shares?

A. No, Mr. Griffin is a qualifying stockholder.

(Testimony of Stanley S. Sayres.)

Q. Pardon?

A. I say, Mr. Griffin is a qualifying stockholder, I think, is that not correct, Tracy?

Q. How many shares does Mr. Griffin hold?

A. I hesitate to say.

Mr. Griffin: One, to my recollection.

A. Well, that is my recollection.

Q. (By Mr. Cromwell): Are there any other qualifying shares? A. No.

Q. Now, who owned the American Properties building prior to 1949, Mr. Sayres, was that always, has that been owned for some number of years by American Properties, how many years has [63] American Properties owned the building occupied by American Automobile Company?

A. I believe since 1933, but I am not absolutely certain of that date. That goes back a good many years.

Q. Where is that building located, Mr. Sayres?

A. Broadway and Madison.

Q. How far from a navigable body of water, would you say, that building is in terms of miles?

A. Well, I would say about three miles.

Q. About three miles from the nearest body of water?

Mr. Griffin: If I may make a little correction, he is thinking about Lake Washington where these run, not the Sound.

The Witness: I was thinking in terms of Lake Washington, I think if you drive right out Madison

(Testimony of Stanley S. Sayres.)

Street from our corner to Lake Washington, it is about three miles.

Mr. Griffin: He said navigable water. Puget Sound is the most navigable water in this part of the world——

Q. (By Mr. Cromwell, interrupting): How far is it from Elliott Bay to the building owned by American Properties, Mr. Sayres?

A. I would say between a mile and a half to two. I don't guarantee the accuracy of that.

Q. Where were the Slo-mo-shun IV and V and also the Slo-mo-shun III housed during 1949 and 1950? [64]

A. The bulk of the time at my residence, but part of the time at Jensen Motor Boat Company.

Q. Do you have a boathouse at your residence?

A. Yes, yes.

Q. Where is your residence, Mr. Sayres?

A. 4450 Huntspoint Road.

Q. Huntspoint Road, is that on Lake Washington? A. Yes.

Q. Will you describe Huntspoint to the court, please, just what it is, its location and what it is?

A. Well, Huntspoint is the tip of a point of land that projects out into the lake.

Q. Is that an exclusive residential district, Mr. Sayres? A. That is open to opinion.

The Court: Maybe the question should be, exclusively a residential area.

The Witness: Yes, it is that, that is, within the immediate area there.

(Testimony of Stanley S. Sayres.)

Q. (By Mr. Cromwell): How far away from the boathouse or your property on Huntspoint is Anchor Jensen's boat building company, would you say, in terms of miles?

A. By land miles it is probably 15, by water it is probably 5.

Q. You, I believe, stated on direct that Slo-mo-shun III [65] was built at Anchor Jensen's, is that correct?

A. Yes, the construction of that boat was started by Mr. Jones out at his house, and then this time didn't permit him what he needed, and it was moved on over to Jensen's and completed there.

Q. What stage of completion was it when it was moved to Mr. Jensen's?

A. I would hesitate to say, perhaps—well, that is a hard question to answer. I might say half, but it is not necessarily correct.

Q. Were Slo-mo-shun IV and V built at Anchor Jensen's, too? A. Yes.

Q. Mr. Sayres, you referred on direct examination to certain technicians that assisted you subsequent to 1949, '49 or subsequent to that year, in preparing these boats and running them in the Gold Cup Races and so forth. I believe you named Mike Welsh, is that correct, as being one of them?

A. Yes.

Q. Who did he work for?

A. He did, and still is, with the Boeing Airplane Company.

Q. Was he a full-time employee with Boeing?

(Testimony of Stanley S. Sayres.)

A. Oh, yes.

Q. At that time? [66] A. Yes.

Q. Who is Elmer Linden Smith?

A. Elmer at that time was with Sunday DeVare, this marine supply company.

Q. Was he a full-time employee at that time with Sunday DeVare? A. Yes.

Q. Now, Ted Jones, who was he employed by at that time?

A. Well, if we talk about—I can't tell you the date that Ted was working for Boeing Airplane Company, when I first got acquainted with him, and all these first endeavors were made. Ted left Boeing, he would have to tell you, but sometime in '51 I believe, the early part, but otherwise he was a fulltime employee of Boeing.

Q. In between times he worked for you in designing and building the boats?

A. His work for me was done nights, weekends and holidays.

Q. Was he ever employed by American Properties, Inc.?

A. Yes, he was, during the period that number V was being built.

Q. You stated that Western Gear Works built the gear boxes for the Slo-mo-shun IV and Slo-mo-shun V? A. Yes.

Q. Did Western Gear Works have any connection with American Properties? [67]

A. Well, no connection.

Q. No business connection?

(Testimony of Stanley S. Sayres.)

A. No, I went to Western Gear to begin with and asked them if they would design and build this first gear box. As a matter of fact, Mr. Scott is the man that arranged with the man for me to see.

Q. Is the gear box an important part of those boats? A. Tremendously, yes, very vital.

Q. You mentioned that Lou Fageol drove these boats in 1951 in the Gold Cup, I believe?

A. Yes.

Q. Is Mr. Fageol, do you know him to be a wealthy sportsman?

A. He is considered to be wealthy.

Q. And now, Stanley Dollar also drove the boats, Slo-mo-shun IV, did you say, in 1952?

A. Dollar won with number IV in '52, correct.

Q. And is he also a wealthy man?

A. I believe so.

Q. Is he of the Stanley Dollar Steamship Lines?

A. Yes.

Q. And Joe Taggart has driven the boats in several Gold Cup Races? A. Yes.

Q. What kind of engines does the Slo-mo-shun IV have in [68] it, Mr. Sayres?

A. Well, in the early years we used Ellison engines, last year we had a Packard-built Merlin engine.

Q. And Slo-mo-shun V, what type of engine did that boat have?

A. V originally had Ellison, and then we went over to the Merlin engine. We first tried the Merlin in '53 in the V.

(Testimony of Stanley S. Sayres.)

Q. Who builds the Ellison engine?

A. Well, it is the Ellison Division of General Motors, Indianapolis. These were all surplus World War II engines.

Q. Who builds the Rolls Royce Merlin engine?

A. Packard Motor Car Company.

Q. When did you set the now world speed record for the first time?

A. June 26, 1950.

Q. And you were driving the boat at that time?

A. Yes.

Q. Did you get a trophy for that?

A. No, I got a diploma, piece of paper.

Q. Were you driving the Slo-mo-shun IV when the Harmsworth Trophy was won?

A. No, Fageol was driving it.

Q. How many times have you won the Gold Cup since the first race in 1950 that I understand you won?

A. Well, I didn't win it at all personally, but the [69] boats won four successive Gold Cups.

Q. Does your name appear on the Gold Cup as the winner?

A. Oh, I suppose it does. I haven't looked at the Gold Cup for a long time.

Q. Were you registered with the American Power Boat Association as the owner, you, Stanley Sayres, in 1950?

A. Yes—I might as well explain that. APBA rules provide that a corporation can't enter a boat.

(Testimony of Stanley S. Sayres.)

It must be entered in any sanctioned regatta by any member of a——

Q. (Interrupting): Just a minute. Answer my question.

Mr. Short: I think he is entitled to an explanation.

Mr. Cromwell: I have no way to check the rules here.

Mr. Short: Then you shouldn't have asked the question. I think he is entitled to fully explain why he is the winner.

The Court: Wouldn't you care to bring that out yourself by questioning him on redirect?

Mr. Short: I don't want it distorted to direct either. I will bring it out.

Q. (By Mr. Cromwell): Mr. Sayres, were you registered with the American Power Boat Association as the owner of Slo-mo-shun IV in 1950?

A. Yes.

Q. Were you registered as the owner of Slo-mo-shun V in 1951? A. Yes. [70]

Q. With the American Power Boat Association?

A. Yes.

Q. Have you always been registered as the owner of Slo-mo-shun IV and Slo-mo-shun V with the American Power Boat Association?

A. Yes.

Q. You stated on direct examination that Slo-mo-shun IV is a two-place boat, is that correct, Mr. Sayres? A. Yes.

Q. That is, two seats, one for the driver and one

(Testimony of Stanley S. Sayres.)

for the mechanic? A. Correct.

Q. And Slo-mo-shun V is a one-place boat?

A. Yes.

Q. What value did you feel these boats would have to the Navy inasmuch as they were one- or two-place boats?

A. Well, certainly you could use the same basic design and build a seventy or eighty-foot boat and perhaps, in our theory, at least, travel a lot faster than any PT boat ever thought of going, as you made the boat bigger you certainly would not be limited to one passenger.

Q. Did you ever build a boat like that, seventy or eighty feet? A. No.

The Court: How much longer did you think cross examination [71] will last?

Mr. Cromwell: About an hour, your Honor, or so.

The Court: This is the usual lunch hour, I think we should adjourn until 2 o'clock for lunch.

(Whereupon, at 12:35 o'clock p.m., the hearing was adjourned until 2 o'clock p.m.) [72]

Afternoon Session

The Court: On the record.

STANLEY S. SAYRES

resumed the stand and testified further as follows:

Cross Examination—(Continued)

Q. (By Mr. Cromwell): Mr. Sayres, were you ever made, appointed, man of the year?

(Testimony of Stanley S. Sayres.)

A. Yes, 1950.

Q. In Seattle? A. Right.

Q. What is that award?

A. Well, that award was originated, to the best of my knowledge, by Brougham and the Seattle P.I.

Q. And what is the award for?

A. Oh, achievement in the sports field.

Q. What other trophies have you won in your racing of speed boats, that is, since 1949?

A. Well, the Gold Cup, the Harmsworth, which, of course, are not my trophies, they are in my possession as long as I hold them, and at one time and another we have won the Martini Rossi Trophy, which was for the fastest heat, I believe in the Gold Cup Race, and there is an Aaron LeRoy plaque for the fastest over-all race average. That is the extent.

Q. Do you personally keep those in your home?

A. No, they stay at the Seattle Yacht Club.

Q. Were you a member of the Seattle Yacht Club in 1949? A. Yes.

Q. And the years subsequent to that?

A. Yes.

Q. Did you hold any job, that is, were you an officer of the Seattle Yacht Club in those years?

A. Well, not right at that time. I was on the Board of Directors for three years, I think somewhat subsequent to '51 or along in there.

Q. Did you personally pay the dues to belong to the Seattle Yacht Club?

A. That I can't say. They may have been paid

(Testimony of Stanley S. Sayres.)

by American Properties or American Automobile Company. I was a member of the Yacht Club for many years before I had a race boat, or that is, the unlimited boats.

Q. Do you subscribe to the Post Intelligencer?

A. Yes.

Q. How long have you subscribed to the Post Intelligencer?

A. Oh, as nearly as I recall, since I have been in Seattle.

Q. That is a daily newspaper? A. Yes.

Q. Have you been personally acquainted with Royal Brougham? [74] A. Yes.

Q. And also Cliff Harrison? A. Yes.

Q. How long have you been personally acquainted with those two men?

A. Oh, I had probably met them long before the race boats became prominent, but I really didn't get acquainted until after that.

Q. Have you granted each of these gentlemen interviews, personal interviews, over the years since you have won the Gold Cup? A. Yes.

Q. Numerous interviews?

A. I would say quite numerous in Mr. Harrison's case, and occasionally with Mr. Brougham.

Q. Do you keep a scrapbook of newspaper and magazine articles respecting the Slo-mo-shuns?

A. Yes, although that has gotten completely out of control, the scrapbook material is stuffed in closets and drawers, it got beyond the scope of putting it together.

(Testimony of Stanley S. Sayres.)

Q. You are pretty familiar, then, with the articles that have been written respecting your boats?

A. Certainly. I have read many of them, and often I am surprised to find one now and then that I have never seen before in my life. [75]

Q. Isn't it a fact, Mr. Sayres, that these articles generally referred to you as the owner of Slo-mo-shuns?

Mr. Short: Objected to as immaterial.

The Court: I will let it in for whatever materiality it may have. It may not be material.

A. Well, certainly in many cases they do.

Q. (By Mr. Cromwell): Refer to you as the owner? A. Yes.

Q. Have you ever tried to correct those statements?

A. Yes, I have tried, but not too successfully.

Q. How have you tried to correct those statements?

A. Well, I have just said that actually the boats are owned by American Properties. On the other hand, I can't, or didn't, feel at least, that I could ask Cliff Harrison, as an example, or Brougham, to please write an elaborate explanation each time he referred to me or the boats, of the technicalities of the ownership. I gave up.

Q. Then this matter of ownership is a mere technicality, then, isn't it, Mr. Sayres?

A. What?

Q. Then the matter of ownership is a mere technicality?

(Testimony of Stanley S. Sayres.)

A. No, I don't regard it as a technicality at all, but in stating myself or being quoted in the press or asked questions on the street corner, yes. [76]

Q. Yes, what, Mr. Sayres?

A. It is a technicality, then.

Mr. Cromwell: Will you mark this, please.

The Clerk: Exhibit "N" for identification.

(Respondent's Exhibit N was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit N marked for identification, which is a copy of the Seattle Post Intelligencer, dated Sunday, June 15, 1952, page 31, and I refer you to the article entitled, "One Slo-Mo out, Stan Sayres says", under the by-line of Cliff Harrison. I refer you also to the quote in that article, and ask you if you stated that to Mr. Harrison?

A. I couldn't testify that that is an exact quotation, but I would not deny that I perhaps referred to the whole thing, the race boat business, as a hobby, many times.

Q. Then you would state that in substance that is a correct quote as quoted by Mr. Harrison?

A. That could be.

Q. Is it or is it not, Mr. Sayres?

A. I don't know. A writer comes up and asks me a series of questions and takes some notes and then goes back and writes the article and sometimes they are put in quotes. Now, I do not deny at all that I may have said, "this hobby" thing. I have [77] said it other times, but whether that is an

(Testimony of Stanley S. Sayres.)

exact word-for-word quotation of what I said, I don't know.

Q. In substance you would say it was a correct quotation? A. I would say it could be.

Mr. Cromwell: I offer Respondent's Exhibit N in evidence.

Mr. Short: No objection.

The Court: It will be received.

(Respondent's Exhibit N was received in evidence).

Mr. Cromwell: Will you mark this, please.

The Clerk: Respondent's Exhibit O for identification.

(Respondent's Exhibit O was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit O for identification, which is a copy of pages 1 and 12 of the Seattle Post Intelligencer newspaper, dated Sunday, June 29, 1952, and I refer you to an article on page 1 of this exhibit entitled, "Seattle Given Chance to Aid Slo-Mo-Shuns", under the by-line of Cliff Harrison. Referring to a continuation of that article on page 12 of Respondent's Exhibit O marked for identification, I ask you to read these quoted quotations and ask you if you made those quotations?

A. I would say those were substantially correct.

Mr. Cromwell: I offer Respondent's Exhibit O in evidence.

Mr. Short: No objection.

The Court: It will be received.

(Testimony of Stanley S. Sayres.)

(Respondent's Exhibit O was received in evidence.)

Mr. Cromwell: Will you mark this, please.

The Clerk: Exhibit P for identification.

(Respondent's Exhibit P was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit P marked for identification, which is a copy of page 18 of the Seattle Post Intelligencer newspaper, dated May 11, 1952. And I refer you to this picture here and also this picture, and ask you if that is a picture of your boathouse?

A. That is right.

Q. At your Hunt's Point property?

A. Yes.

Q. And is this a picture of your home?

A. Right.

Q. The same location? A. Yes.

Q. Will you read that, please?

Mr. Short: Just a moment. We have been furnished copies [79] of previous articles. This is new to me and I don't think it should be read in the record until displayed to counsel and otherwise identified.

The Court: You didn't mean to read it aloud, did you?

Mr. Cromwell: Not to read it aloud, Mr. Short.

Mr. Short: Oh.

Q. (By Mr. Cromwell): Is that a description of your boathouse and your home, Mr. Sayres?

A. Well, I think it is. Frankly I don't follow

(Testimony of Stanley S. Sayres.)

the society pages too closely, and I don't try to edit those word for word.

Q. But you would say that is a reasonable description of your home and boathouse?

A. The boathouse and the house, yes.

Mr. Cromwell: I offer Respondent's Exhibit P in evidence.

Mr. Short: Why? I object to this as being utterly irrelevant. This is Mr. Sayres' home.

Mr. Cromwell: It is also a picture of the boathouse where the Slo-Mos are kept, and this is merely corroborative of the testimony.

Mr. Short: It is an attempt to prejudice the witness.

The Court: I take it to be admissible in connection with the statement that the boat was kept at his house or in the [80] boathouse near his house. I would receive it for one purpose only, of showing the boathouse where the boat is kept.

Mr. Short: May I renew my objection and add that, of course, the boat has to be kept on the water. The man lived at the time of that article in 1952, on the water. During the taxable years involved he did not live at the residence portrayed in that photograph. It is irrelevant to any issue in 1949.

Mr. Cromwell: He testified right along all the way up to 1956 about these boats, and he opened the entire thing up as to that, and he has also testified on cross examination that he kept these boats at this particular boathouse.

The Court: During what years?

(Testimony of Stanley S. Sayres.)

Mr. Short: That is the question.

Mr. Cromwell: Well, the years were not identified.

Mr. Short: Why don't you ask him where he lived in 1949?

The Court: What are the years in question here?

Mr. Cromwell: 1949 and 1950, your Honor. However, in a case of this nature involving a hobby, claim of a hobby and so forth, the substantive evidence is very relevant.

The Court: The substantive evidence may have some value. I will receive it for that one limited purpose of showing the place where the boat has been kept.

(Respondent's Exhibit P was received in evidence.) [81]

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit H, which is the corporation income tax return of American Properties for the year 1950. Referring to page 3 of that return, Schedule "K" listing other deductions, we have a figure, there is a figure in red called "Expense contributions (travel, et cetera, \$6,912.15). Will you state what that represents?

A. Well, I assume that is the amount paid by Greater Seattle to defray part of my 1950 expenses.

Q. Of operating the Slo-Mo-Shun IV?

A. Right, yes.

Q. Was that amount of money paid to you or to American Properties?

A. Well, the money went to American Proper-

(Testimony of Stanley S. Sayres.)

ties, I can't tell you offhand whether the check was originally made to me and then deposited to American Properties by me or not. American Properties was the final recipient.

Q. What is Greater Seattle, Mr. Sayres?

A. Well, that is an organization that was promoting the annual Sea Fair and numerous other events during the year. The general aim, I think, is to put Seattle on the map in one fashion or another. As you know, they have sponsored not only boat races, but football games and the Aqua Follies and many, many events, all the way through the year.

Q. Is Greater Seattle a profit-making corporation? [82]

A. I think not.

Q. How does it raise its funds?

A. Memberships, public subscriptions.

Q. Will you tell us why it is that Greater Seattle made this contribution to American Properties, Inc., in 1950, or to yourself?

A. They thought that the bringing of the Gold Cup Race by virtue of my winning it might be a very desirable thing for Seattle to have in the way of bringing crowds of people here and nation-wide publicity for Seattle.

Q. Did you appeal to Greater Seattle for this contribution?

A. No, I would say not.

Q. It was voluntary you would say?

A. Yes.

Q. Did you ever receive any more contributions from Greater Seattle to operate the Slo-Mo-Shun

(Testimony of Stanley S. Sayres.)

boats? A. Subsequent to this?

Q. Subsequent to this. A. Yes.

Q. What were those amounts, do you recall?

A. No, I hesitate to name them.

Mr. Short: I object to getting out of the years '49 and '50 on this issue.

Mr. Cromwell: Your Honor, they have gotten out of the years continuously on direct examination. They have carried [83] it right on through, Mr. Sayres testified that Slo-Mo-Shun V wasn't built until 1951. Now, that is certainly outside of our taxable year.

Mr. Short: There should be some relevancy to getting out of the taxable year.

Mr. Cromwell: He also testified who won the races in '52, '53 and '54 and they won the Gold Cup in subsequent years.

The Court: I think that is true, and I don't know just what bearing it may have, but I think the cross-examination can pursue it to the extent that the direct examination did, if you think it is material to your case.

Q. (By Mr. Cromwell): Did Greater Seattle ever sponsor any campaigns to raise money for you to operate these boats, Mr. Sayres? A. Yes.

Q. Did they advise the public that the American Properties, Inc., owned these boats?

A. I don't think so.

Q. Did they hold you out as the owner of the boats?

(Testimony of Stanley S. Sayres.)

A. I can't answer that flatly, I would assume, yes.

Mr. Cromwell: Will you mark this.

The Clerk: Exhibits "Q", "R", "S", "T" and "U" for identification.

(Respondent's Exhibits Q, R, S, T & U were marked for identification.) [84]

Q. (By Mr. Cromwell): I hand you Respondent's Exhibit Q marked for identification, and ask you if you—which purports to be Sea Fair Regatta official program dated August 2-12, 1951, published by Greater Seattle, Inc., and I ask you if you ever saw that? A. Oh, yes.

Q. Referring to page 3 of this exhibit, marked for identification, I refer you to that (indicating) statement. Did you ever see that before?

A. Oh, yes, I have seen that.

Q. This statement as to "Owner, Stanley Sayres"? A. Yes.

Q. Referring to page 11 of Exhibit Q marked for identification, I refer you to the column headed, "Summary of American Power Boat Association Gold Cup Races", and under the column, "Owner, Stanley S. Sayres"? A. Yes.

Q. Had you seen that? A. Yes.

Mr. Cromwell: Your Honor, Respondent offers Exhibit Q marked for identification, in evidence.

Mr. Short: I can't see the materiality of the exhibit itself.

The Court: Do you object to the competency?

Mr. Cromwell: I think I can tie it up, your Honor. [85]

(Testimony of Stanley S. Sayres.)

Mr. Short: In view of his testimony I see no relevancy to the magazine itself, no competency.

Mr. Cromwell: Your Honor, these ownerships can be shown by tacit admissions, admissions by silence, and there are certain admissions in these, that is, certain statements as to "owner, Stanley S. Sayres".

The Court: Is this some sort of an official magazine?

Mr. Cromwell: That is the official regatta program.

Mr. Short: I take it counsel has no law to prove that silence proves something.

The Court: On what?

Mr. Short: He indicated that title can be shown by silence. I think that is getting a little bit far-fetched.

Mr. Cromwell: That goes to indicate, a tacit admission, your Honor, the failure to deny an official program put out, stating that Mr. Sayres is the owner.

The Court: Well, the Court is concerned with what the actual facts are as to ownership, of course. As I have indicated before mere statements in newspapers and such I don't consider competent evidence. But this may be in a different category if this is the official regatta program as it appears to be, I think it is admissible for the purpose of showing that it was entered in the regatta and you may, Mr. Short, show on redirect, whether that has any bearing upon the true ownership.

(Testimony of Stanley S. Sayres.)

Mr. Short: We are perfectly willing to stipulate that [86] in all entries.

Mr. Griffin: All entries were put in by the individual and not by the corporation.

The Court: Is there any need for cluttering up the record then of any program of this sort, if it can be stipulated it was entered in as owner by this petitioner?

Mr. Cromwell: Your Honor, I would like to have the official programs in evidence.

The Court: Is there any other purpose in putting them in than to show that fact?

Mr. Cromwell: Well, yes, your Honor. It shows that Mr. Sayres was held out by Greater Seattle who contributed, admittedly, to the operation of these boats, they held him out as the owner of the boats.

Mr. Griffin: He has so conceded in his testimony.

Mr. Cromwell: And he never denied it, public subscriptions were made to promote these boats of Mr. Sayres'.

The Court: Can't that be conceded between the parties?

Mr. Griffin: It is.

The Court: Let us make a statement of some sort for the record to which the parties can agree and not put too much of this in the record. Who puts out this magazine?

Mr. Cromwell: Your Honor, Greater Seattle, Inc., it states right on the cover.

The Court: Do I understand that Greater Seat-

(Testimony of Stanley S. Sayres.)

tle, Inc., [87] did get public contributions on the basis of representing——

Mr. Cromwell (interrupting): On the basis of representing Mr. Sayres to be the owner of the Slo-Mo-Shun boats.

The Court: Well does this prove that?

Mr. Cromwell: This shows that, yes, it is the official program, your Honor, published by Greater Seattle, that isn't denied, is that correct, Mr. Short, these are the official programs?

Mr. Short: I haven't even seen it, I wouldn't know if I looked at it and that is why I didn't look at it. I have no office with Greater Seattle. I wouldn't know their program.

Mr. Cromwell: Mr. Sayres has identified it.

Mr. Short: I know he has, and he says that they hold him out as the owner. This isn't left to proof. You are cluttering the record.

Mr. Cromwell: I would like for it to go in the record, your Honor, and the Court may give it whatever weight it sees fit.

Mr. Short: It is incompetent to establish anything that isn't already admitted.

The Court: It is incompetent to prove anything except that in the Regatta it was represented that this petitioner was the owner of the boat so far as I know now. If you insist I will receive it for that purpose.

Mr. Cromwell: That is the basis of our offer, your [88] Honor.

(Testimony of Stanley S. Sayres.)

(Respondent's Exhibit Q was received in evidence.)

Mr. Cromwell: I also have the same thing for 1952, 1953, 1955 and 1955. 1952, Respondent's Exhibit R, is offered for the same purpose.

The Court: Well, I will receive them for that purpose only and not as proof of any facts contained in these magazines.

Mr. Short: May our objection run to all of them?

The Court: It may.

(Respondent's Exhibit R was received in evidence.)

Mr. Cromwell: I offer Respondent's Exhibit S in evidence, which is the official Sea Fair Program published by Greater Seattle, Inc.

Mr. Short: Same objection.

(Respondent's Exhibit S was received in evidence.)

Mr. Cromwell: I offer Respondent's Exhibit T in evidence, which is the official Sea Fair program published by Greater Seattle.

Mr. Short: Same objection.

The Court: It is received.

(Respondent's Exhibit T was received in evidence.) [89]

Mr. Cromwell: I offer in evidence Respondent's Exhibit U, which is Greater Seattle's official Regatta program for the year 1955.

Mr. Short: Same objection.

The Court: The objection is overruled. It will

(Testimony of Stanley S. Sayres.)

be received for that limited purpose that I indicated above.

(Respondent's Exhibit U was received in evidence.)

Q. (By Mr. Cromwell): Mr. Sayres, did you ever make any effort to have these statements corrected in these official programs as to your ownership?

A. I can't make any effort to have a statement corrected under the A.P.B. rules when they state me as owner.

Q. Just a moment. Will you answer that yes or no, have you ever made any effort to have those statements corrected in those official records?

A. No. After they are published I can't do anything.

Q. Did you ever have any opportunities to sell Slo-Mo-Shun IV, Mr. Sayres?

A. Second-handed, yes, not directly to me. That is, frankly, Mr. Jones told me at one time that Mr. Horace Dodge wanted to buy it.

Q. Did you refuse to sell it?

A. No, I won't say that I refused, but I wanted somebody [90] to talk directly to me about it.

Q. Did you try to talk directly to Mrs. Dodge?

A. No.

Q. Weren't you interested in making a profit on the sale?

A. Had I had a bona fide offer——

Q. (Interrupting) Yes or no, Mr. Sayres.

(Testimony of Stanley S. Sayres.)

Mr. Short: I don't think that is a yes or no question.

The Court: He can give a yes or no answer and then explain it. What was the question?

(Second preceding question read.)

A. I would say no, because had I sold it in 1950 that would have probably ended any hopes I had of going on with the development, continuing development and getting into the boat business. It could have. That is a question that nobody can answer flatly. And I am quite sure had I had a large enough bona fide offer, I would have probably taken it.

Q. Couldn't you have built another boat just like Slo-Mo-Shun IV?

A. I am not sure, Number V was not like IV.

Q. Number V had a different design?

A. No, fundamentally the same design, minor differences.

Q. Is No. V an unsuccessful boat?

A. No.

Q. Did you ever have any trouble with Slo-Mo-Shun V? A. Yes. [91]

Q. Was it your hard-luck boat, Mr. Sayres?

A. Well, it was hard luck, but it had certain characteristics that we weren't quite as happy with as we were with No. IV.

Q. Why couldn't you duplicate IV, Slo-Mo-Shun IV?

A. Well, I am not going to sit here and say that you couldn't duplicate it, but I sit here and do say

(Testimony of Stanley S. Sayres.)

that it is awfully seldom that you build two boats and have them come out just the same.

Q. You had the plans for Slo-Mo-Shun IV?

A. Yes.

Q. Do you still have the plans for Slo-Mo-Shun IV?

A. I think they are out at Jensen Motor Boat Company. I don't have them.

Mr. Cromwell: Will you mark this.

The Clerk: Respondent's Exhibit V.

(Respondent's Exhibit V was marked for identification.)

Q. (By Mr. Cromwell): Mr. Sayres, I hand you Respondent's Exhibit V marked for identification, which is a copy of page 17 of the Post Intelligencer newspaper of Tuesday, December 19, 1950, and under the heading, the article, "Slo-Mo's owner has offers to consider." I refer you to a quote in that article and ask if those are your words.

A. I can't say that they are. [92]

Q. Do you deny then that they are your words?

A. I won't flatly deny it and I won't flatly admit it, because I can't remember exactly what I said to a reporter that far back, the precise wording. General purport of that is correct to a limited extent. Here it says, "Two very fancy offers." I don't think I said, "Two very fancy offers."

Q. Did you have several offers or no offers at that time?

A. No, I think—yes, I think we had had this approach around about presumably from Mrs.

(Testimony of Stanley S. Sayres.)

Dodge. Now, certainly I have had other inquiries about those boats, would I sell it and if I would sell it, how much would I want. I do not believe that I flatly stated I had two very fancy offers.

Q. And you do deny that part of the quote?

A. I would deny that part of the quote.

Q. Now, referring to this part of the quote, did you make that statement, starting here (indicating) with "Unless"?

A. I might have made that, if I had a tentative offer and I wouldn't be sure of anything until it was laid in front of me in tangible form.

Q. That quote states that you wouldn't sell under any circumstances without having a Gold Cup defender, another one already built?

A. I have no doubt that I said that, because in the position of holding the Gold Cup, if I failed to defend it would have moved right back out of Seattle and I would have been [93] certainly unpopular in the area.

Mr. Cromwell: I offer Respondent's Exhibit V.

Mr. Short: The statement he just denied.

Mr. Cromwell: The first ones he denied.

Mr. Short: I object to the competency and relevancy of the exhibit. It is hearsay statement in any event. It can't be even contributed.

Mr. Cromwell: He said he would not sell the first boat unless he had a second boat ready for competition in the Gold Cup.

The Court: Does this purport—who does this purport to be a statement to?

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: By Mr. Sayres.

The Court: To whom?

Mr. Cromwell: To whoever wrote the article.

The Court: Normally the way you prove that is bring in the witness who heard the statement. Now, if Mr. Sayres wants to admit that he said some of this, why, I can accept it.

Mr. Cromwell: He has, your Honor, admitted that last sentence beginning with "Unless".

The Court: It isn't this that is the evidence, it is Mr. Sayres' testimony that is the evidence it seems to me. I think you will have the same result in the record as if you had put this in. I don't think it is competent evidence myself. Unless you have the person here. [94]

Mr. Cromwell: Your Honor, this whole case rests on the business motive versus the hobby motive. Now, if he was in the business of building boats or trying to build these boats up to sell, it seems to me it is very material that this statement is an admission against interest in this case, certainly, and it is a deserving statement. And for that purpose I would like it admitted.

The Court: As I understand it the witness has said that he had had some indirect offers and if there had been a big enough price he would have sold. And he says that he did say at this time that he would not sell, however, unless he had another boat to defend in the races.

The Witness: Yes, sir, that is correct.

The Court: Now, if the petitioner objects to

(Testimony of Stanley S. Sayres.)

that on the grounds of competency, I don't see how I can allow that in evidence.

Mr. Cromwell: Your Honor, if that is so stipulated, that which you have just stated, I will not make any further attempt to put this exhibit in evidence.

Mr. Short: I don't know why you need a stipulation, that is what the man said and the Court has just repeated what he said. I don't know why I am called upon to stipulate to what he has already testified.

The Court: I think that is what the witness has testified and I believe he just said that that was the substance [95] of what you testified?

The Witness: Correct, yes.

Mr. Cromwell: May I make an offer of proof, your Honor?

The Court: You may make an offer of proof.

Mr. Cromwell: If Respondent's Exhibit V was admitted into evidence, it would show the following: In the Seattle Post Intelligencer, Tuesday, December 19, 1950, on page 17 under the heading, the article headed, "Slo-Mo's owner has offers to consider", the following quotation or statement is made by Mr. Sayres, "We have two very fancy offers for the craft. Might sell her if it appears conditions are such that we can build a new one. Unless we can be sure, however, there will be no deal, under no circumstances can we be without a cup defender come August, said Sayres."

The Court: Objection sustained. This is merely

(Testimony of Stanley S. Sayres.)

an article in the newspaper and it doesn't show who wrote it. The person who wrote it is apparently not in court.

(Respondent's Exhibit V was rejected.)

Mr. Cromwell: That is all.

Redirect Examination

Q. (By Mr. Short): Mr. Sayres, was it ever your thought that you were building Slo-Mo-Shun IV for the purpose of selling that [96] particular boat? A. No.

Q. What was your purpose in building the Slo-Mo IV?

A. It was to establish the designs and the ideas that we had gathered together and prove them out.

Q. It was the pilot model of this new design, was it not? A. That is right.

Q. You were asked in reference to—oh, by the way, do you, in the years that you have been interested in the Gold Cup races, has it ever been in your opinion, of any interest to the public who the owner, that is, as between you and the corporation, who the owner of any of these boats was?

A. Not in the least.

Mr. Cromwell: I object, your Honor, Mr. Sayres is not qualified to testify as to what the public feels.

Mr. Short: That is all he was asked about, that is what all of these newspapers are.

Mr. Cromwell: It was what he was held out to

(Testimony of Stanley S. Sayres.)

the public to be, your Honor, not what the public thought him to be.

The Court: He can express his opinion as to what he thinks the public wants. I don't know what weight it would have. I don't think he is qualified to say what the public reaction would be, but he may give his opinion. [97]

Q. (By Mr. Short): Do you have an opinion as to whether it would have made any difference to the public to outline to them the setup of American Properties, Inc., and your relation to the corporation?

A. Certainly in my opinion it didn't mean a thing to the public.

Q. You were interrupted in your explanation of why in the various regattas whether it was Sea Fair or Gold Cup or Harmsworth or any other competition, why these boats or any of them, are raced in your name. Will you explain that?

A. That is the result of the American Power Boat Association, who have jurisdiction over all sanctioned regattas. In the rule book it very specifically states that a corporation cannot enter a boat in a sanctioned race. It goes on and provides that a corporation can charter——

Mr. Cromwell (interrupting): I think the rule book would be the best evidence.

The Witness: It is here.

Mr. Cromwell: You better put it in then.

Mr. Short: Will you mark this.

The Clerk: Exhibit 5 for identification.

(Testimony of Stanley S. Sayres.)

(Petitioner's Exhibit No. 5 was marked for identification.)

Q. (By Mr. Short): Mr. Sayres, when you referred to the A.P.B.A., what [98] do those initials stand for?

A. American Power Boat Association.

Q. I hand you what the clerk has marked for identification as Petitioner's Exhibit 5, and I will ask you what that is.

The Court: I think maybe counsel will agree with you on that.

Mr. Cromwell: No objection, your Honor.

The Court: What is it?

Mr. Short: This is the 1956 Rule Book of the American Power Boat Association, and it bears the caption, "Section 2, Volume 10, No. 4." The clerk has marked it on page 98, where Rule 3 appears, and I will offer the entire volume.

Mr. Cromwell: No objection, your Honor.

The Court: It will be received in evidence.

(Petitioner's Exhibit No. 5 was received in evidence.)

Q. (By Mr. Short): Do I understand that it is your interpretation of that Rule 3 that causes you to enter in competition these boats under your name?

A. Yes.

Mr. Cromwell: I object to his interpretation of it, your Honor, and move that the answer be stricken.

The Court: Strike the answer and rephrase your question. [99]

(Testimony of Stanley S. Sayres.)

Q. (By Mr. Short): Now that this exhibit is now in evidence, will you please now state why you enter the Slo-Mo-Shuns in competition under your own name rather than under American Properties?

A. The rules require it.

Q. Do you know of your own knowledge whether there are unlimited class hydroplanes racing under those rules under the name of individuals, the ownership of which is elsewhere?

Mr. Cromwell: I object to that question, your Honor, as immaterial, as to the ownership of other boats. We are dealing with Mr. Sayres' boats now, Slo-Mo-Shun IV and V.

Mr. Short: We are showing that the practice in the power boat association, as far as racing and the construction of those rules is concerned.

The Court: Your objection is on what grounds?

Mr. Cromwell: My objection is that it is immaterial, your Honor, as to the other boats. We are dealing here with Mr. Sayres' boats, Slo-Mo-Shuns IV and V, and not with somebody else's boats, and his opinion as to what they were or how they were registered or how they would be material.

The Court: And yet you are trying to show that because these rules require that the owner be the man listed that must mean that the boat was owned by him, they are trying to refute that by showing that isn't necessarily so because [100] there are others who have entered boats which they really did not own. Is that the substance of it?

Mr. Short: That is exactly correct, your Honor.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Your Honor, the records of the association, the American Power Boat Association, is the best evidence of that. If they want to put the records of the American Power Boat Association in evidence that is all right.

The Court: We are on ticklish ground here because here is the matter of our very case, the question is who owns these boats. It is ticklish to have this witness testify as to who owns other boats. I think we need some very good proof of who was the owner of the other boats. As I say, that is the very controversy here. It could be in the other cases he may want to testify about.

Mr. Short: My point in pursuing this line of testimony is to show that because it is registered in the name of an individual does not deny that the actual ownership is in the corporation.

The Court: You mean it may be leased, chartered?

The Witness: Chartered.

Mr. Short: Well, chartered in an extremely informal way, but that boats owned by corporations are entered in the name of the person, either who drives them or who sponsors them or is interested in them. And it does not affect the question of ownership. It is simply a formal matter of registration for [101] entry in the Regatta. The rules preclude the corporation from making that entry.

The Court: I would have to be pretty sure that I knew that this witness knew the facts regarding ownership.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: It is not the best evidence, your Honor.

The Court: No, it is the formal matter.

Mr. Short: It is not a matter of formal documentation in items——

Mr. Cromwell (interrupting): I never saw these American Power Boat Association rules before, but Rule 3 of Exhibit 5, Petitioner's Exhibit 5, paragraph 1, states, that "Each boat entered for a sanctioned race must be the bona fide property of the person in whose name she is entered and who must be a racing member of the American Power Boat Association and a member of a club belonging to this Association." Now, the question of ownership of other boats, Mr. Sayres is not qualified to testify to.

Mr. Griffin: The same rule applies that corporations cannot enter.

The Court: If you would like to ask him that question you would have to lay a foundation for showing how he knows.

Mr. Cromwell: Do I understand your Honor's ruling to be—— [102]

The Court (interrupting): I am sustaining your objection at this time unless Mr. Short qualifies the witness further as to his actual knowledge of ownership or how he knows or has some further proof.

Mr. Short: The question was whether he knows.

The Court: You may ask him that question, of course.

(Testimony of Stanley S. Sayres.)

Q. (By Mr. Short): Do you know whether or not in unlimited hydroplane racing any of these boats entered by individuals are owned by other than the individual in whose name it is entered?

A. I can't produce positive proof. I have been told and I think it is correct—I can——

Mr. Cromwell (interrupting): Just a moment, that is hearsay.

Mr. Short: No, that that he said isn't hearsay.

Q. (By Mr. Short): Go ahead.

A. If you will read through the A.P.B.A. book the listing, you won't find any corporation attached to any boat record or any boat performance, it is always an individual, anywhere in it, because it must be entered by the individual, and it can be chartered from the corporation.

The Court: That is under those rules?

Mr. Short: Yes. [103]

Q. (By Mr. Short): And you have Exhibit U before you there? A. Yes.

Q. You see the reverse side of that is an ad for Miss Thriftway, is that an unlimited hydroplane? A. Yes.

Q. Are there a chain of stores known as the Thriftway Chain in this community? A. Yes.

Q. Owned by the Pacific Gamble Robinson Company, a corporation?

A. I don't know the ownership of the chain.

Q. Under whose name is that boat entered?

A. Willard Rhodes.

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: Does he know of his own knowledge?

Q. (By Mr. Short): Do you know of your own knowledge who entered that boat in the Gold Cup races?

A. I am sure the A.P.B.A. records would show that Willard Rhodes owns it.

Mr. Cromwell: Do you know that of your own knowledge?

Q. (By Mr. Short): Does that Sea Fair program, Exhibit U, indicate whose name the Miss Thriftway boat is entered in, the listing?

Mr. Cromwell: The records of the American Power Boat Association are the best evidence. This is certainly not [104] evidence of ownership of other boats and how they are registered.

The Court: I don't think the witness should answer unless he knows.

Mr. Short: I am asking him to look now and see if the exhibit doesn't state that the Thriftway entry is actually under Mr. Rhodes' personal name.

A. Yes, Miss Thriftway, owner Willard A. Rhodes, Exhibit U, page 17.

Q. (By Mr. Short): Who enters Miss Pepsi?

A. Well, I presume it was Walter Dawson. Now, if you have the old program where I can see.

Mr. Cromwell: Do you know of your own knowledge?

The Witness: It was Walter or Roy Dawson, two brothers.

Mr. Cromwell: You are not sure?

(Testimony of Stanley S. Sayres.)

The Witness: I am saying it was one or the other.

Mr. Cromwell: You are not sure?

The Witness: If we can find the program we can tell.

Q. (By Mr. Short): Are there two Dawson brothers? A. That is right.

Q. One of them is always entered as the owner?

A. That is right.

Q. What is the business of the Dawson brothers?

A. It is the Pepsi-Cola Bottling Company of Michigan.

Q. Who enters Such Crust?

A. That was Jack Shafer.

Q. What is Jack Shafer's business?

A. Shafer's Bakers.

Q. Can you furnish us with others?

A. I can say this, here is the entry list and here is the owner named with each boat, and it always is an individual.

The Court: Is this in evidence for that purpose, this exhibit?

Mr. Short: I am not sure what purpose counsel put it in for.

The Court: I allowed the programs in evidence merely for the purpose of showing that this particular boat was entered in the name of this particular individual.

Mr. Short: Yes.

The Court: Now, we have the witness not know-

(Testimony of Stanley S. Sayres.)

ing of his own recollection apparently, who entered other boats, but he is reading from this exhibit.

Mr. Short: Well, to the extent that he is reading from it I would ask that it be admitted for the other entries as well.

The Court: I see. Very well.

Mr. Cromwell: Is that for the purpose of showing ownership, your Honor? [106]

The Court: No, it is not for that purpose.

Mr. Short: That is what you put it in for.

Mr. Cromwell: I put it in to——

Mr. Short (interrupting): I would like an explanation of what he put it in for if it wasn't for ownership.

The Court: He put it in for the purpose of, as I understand it, tending to indicate ownership in this individual. Now, as you say, that doesn't necessarily prove ownership, that mere fact.

Mr. Short: What is the status now? I have offered them for the other entries, the exhibits, to show that they are entered by those individuals despite the fact that they advertise a product.

The Court: Is there any objection to having them in for the purpose of showing what the other entries were and in whose name they were?

Mr. Cromwell: Not as far as the official program is concerned, no, your Honor.

The Court: Very well. They will also be received for that purpose.

Q. (By Mr. Short): Is Greater Seattle, Mr. Sayres, a corporation? A. Yes.

(Testimony of Stanley S. Sayres.)

Q. What is its approximate membership, if you know?

A. I hesitate to answer that. I have seen quotations in [107] the newspapers, but you have a representative from Greater Seattle here.

Q. You say we do?

A. Yes, Mr. VanCamp, the managing director.

Q. Where did you live in 1949?

A. 3140 East Laurelhurst Drive.

Q. Is that in Seattle? A. Yes.

Q. City limits? A. Yes.

Q. Out on Lake Washington? A. Yes.

Q. Have either of the Slo-Mo-Shuns been in the real estate owned by American Properties?

A. Yes, No. IV.

Q. Are any aircraft engines, that is, these Ellison or Merlin engines that you referred to or other parts for the engines and other portions of the boats stored on the properties of American Properties at Broadway and East Madison?

A. Yes. We also do our engine work there.

Q. Do you have a machine shop on the premises of American Properties, which assembles these engines?

A. Well, we have a machine shop of limited scope, yes.

Q. When in your letter to Alexander you indicated that you had paid certain amount of money for the operation, maintenance [108] and construction of these vessels, what does that reference mean? A. Well——

(Testimony of Stanley S. Sayres.)

Q. (Interrupting) In other words, what were you answering when you made that remark?

A. I meant that, well even Greater Seattle or any other organization had not subsidized this program and in saying "I" I perhaps have done that many times, not bothered to write a long explanation of the fact that here was two, here was American Properties, I might say the same thing if you asked me what car I drove down here today, I would say it was my model so-and-so, the car technically belongs to Stanley Sayres, Incorporated, not to me individually.

Q. And Alexander had indicated that Greater Seattle had paid the expense of this Gold Cup to which he had reference——

A. (Interrupting) Which year are you referring to, Ken?

Q. 1953. I remind that your letter is dated September 21, 1953, to Alexander, he had just previous to that, published this editorial, that is the period of time I am referring to.

The Court: Are we going back and testify about that editorial that I refused to allow in evidence?

Mr. Short: Well, I take it that he has answered the question. I may be repeating. I believe that is all. [109]

Recross Examination

Q. (By Mr. Cromwell): Mr. Sayres, when did you move to the Hunt's Point property?

A. Approximately the middle of December, 1950.

(Testimony of Stanley S. Sayres.)

Q. Did you always have a boathouse at the Laurelhurst property?

A. No, just a dock with a cover over it.

Q. Did you keep the Slo-Mos there? The Slo-Mo III, I believe would be the only one you owned in 1949.

A. Yes, it was kept there.

Q. Now, you testified regarding the fact that the engines or some of the engines, anyhow, used in these boats Slo-Mo-Shun IV and V, were kept at the building, American Properties building?

A. That is right.

Q. Who worked on these engines?

A. My own crew.

Q. Your own crew? A. Yes.

Q. Do you mean your crew for your automobile company, American Automobile Company?

A. No, the race boat crew.

Q. Who was there?

A. Well, I named some of them this morning.

Q. Will you repeat those, please?

A. Well, shall I give you the crew as it is today? If I tried to go back, there has been men added and men lost.

Q. Well, maybe I can develop it. Was Mike Welsh on that crew?

A. He has been on all the way through.

Q. And Linen Smith? A. Yes.

Q. Did Ted Jones work on the engines?

A. Well, not on the engines as such, no. He may have assisted. These men know one of them is limited to just one little thing to do.

(Testimony of Stanley S. Sayres.)

Q. In other words, the men that worked on the engines were not employed either by American Properties or American Automobile Company?

A. One man that has worked on engines for the last three years is employed by American Automobile Company, but back in these years he was not on the crew.

Q. Isn't it true that American Automobile Company owned the equipment that was used to work on these engines, Mr. Sayres?

A. Very, very rarely. All the hand tools, the small tools, were not the property of American Automobile Company, and I suppose that at times, why, somebody might be in and use an American Automobile lathe or might use a vise, but we even used an electric hoist up there which did not belong to American [111] Automobile Company.

Q. Who owned the hand tools, Mr. Sayres?

A. American Properties.

Q. Are they on their books?

A. I assume they are.

Q. Well——

A. (Interrupting) I couldn't answer that directly.

Q. When did you build the boathouse on the Hunt's Point property, Mr. Sayres?

A. Well, it was built along at the time that the house was being built, but I can't say when it was finished. I think it was perhaps the spring of '51, although it may have been during the winter. I don't recall the exact dates on that.

Mr. Cromwell: I have no further questions.

Mr. Short: That is all.

The Court: You are excused.

(Witness excused.)

The Court: We will recess for about ten minutes.

(Short recess.)

The Court: On the record, please.

Mr. Short: Call Mr. Griffin.

TRACY GRIFFIN

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows: [112]

The Clerk: Will you state your name and address, please, for the record.

The Witness: Griffin, G-r-i-f-f-i-n, Tracy E. 1616 34th Northwest.

Direct Examination

Q. (By Mr. Short): What is your occupation, sir? A. Attorney at law.

Q. How long have you practiced law?

A. Forty-one years as of July of this year.

Q. In Seattle? A. In Seattle.

I have lived in Seattle for a long time.

Q. Are you a past president of the Seattle and Washington State Bar Association? A. Yes.

Q. Are you presently a delegate from the Seattle Bar Association to the American Bar Association?

A. I am.

Q. How long have you been in that capacity?

(Testimony of Tracy Griffin.)

A. Since 1948.

Q. How long have you represented Mr. Sayres?

A. From the time he came to Seattle, which as I recall, was in the fall of 1931.

Q. I hand you what has been admitted in evidence as [113] Exhibit 4, the record of the Board of Directors of American Properties, Inc. I will ask you if that is your signature?

A. It is, under the heading of Secretary.

Q. Did a meeting represented by those minutes, take place on the day recited in those minutes?

A. Yes, sir.

Q. And is that—

A. (Interrupting) Now, let me qualify that by saying this, the minutes were signed on the day that is shown here, they may have been dictated the day before or something like that. I have no personal recollection of the day.

Q. That is a bona fide meeting that took place when those matters were discussed? A. Yes.

Q. Would you tell the Court what discussion between yourself and Mr. Sayres, Mr. Scott, and/or Mr. Munger, or either or any of them, took place in reference to the ultimate resolution which was passed?

A. Well, my primary discussion was with Mr. Sayres in which he was entering this new venture with Slo-Mo-Shun IV building. And the matter arose of the necessity of incorporating. It is my recollection that Mr. Sayres remembered that the Williams Motor Company, by its very wording,

(Testimony of Tracy Griffin.)

provided for the construction of boats and marine supplies or engines, and that was at that time American Properties, Inc., and that company was [114] in a position to take over this new venture without the necessity and cost of forming a new corporation and setup. That is why it was done. Mr. Sayres very definitely entered into this venture with the idea of not only having it pay its own way, but of being a profitable enterprise. I heard his testimony in regard to the navy situation, I confirm that conversation with him. It was days back there where he was very optimistic and the optimism continued in——

Q. (Interrupting) Optimistic in reference to what?

A. In being able to have a new profitable venture in the building and construction of these boats, the sale of boats, the sale of rights to the boats, perhaps certain marine equipment as time went on.

The Court: May I interrupt?

Mr. Short: Surely.

The Court: Does it appear here that the relationship of two businesses, are there two corporations involved?

Mr. Short: No, there are two names to the same corporation, Williams Motors was the original corporation that Mr. Sayres acquired, changed its name to American Properties.

The Court: Isn't that another company?

The Witness: I might testify about that.

(Testimony of Tracy Griffin.)

Mr. Short: There is an American Automobile Company.

The Court: Yes, well what relation is that to the other corporation, any? [115]

Mr. Short: It is the tenant of American Properties. The American Automobile Company, which is now Stan Sayres, Inc., this is confusing because of the name change, but American Automobile Company was the Chrysler-Plymouth first distributor and then dealer. That corporation's name has been changed now to Stan Sayres, Inc. That is the one that operated until a month ago. The Chrysler-Plymouth dealership and the premises which it occupies, are owned by American Properties.

The Court: Are both of them corporations?

Mr. Short: There is only one item of property. It is occupied by the automobile dealership.

The Court: I understand, but first you have the corporation that owns the building?

Mr. Short: That is right.

The Court: What is the name of that?

Mr. Short: American Properties.

The Court: And the taxpayer, Mr. Sayres, owns practically all the stock of that?

Mr. Short: That is true.

The Court: What about the dealership, is that—that is not a corporation?

Mr. Short: Yes, that is Stan Sayres, Inc., formerly American Automobile Company.

The Court: And Mr. Sayres owns that, too?

(Testimony of Tracy Griffin.)

Mr. Short: He does not own all but the qualifying [116] shares as he does in the other, there are other stockholders in that corporation, but he is the principal stockholder.

The Court: Is that material here? It is somewhat confusing.

Mr. Short: I think this witness can straighten it out.

Q. (By Mr. Short): Did you organize American Automobile Company?

A. Yes, sir, the American Automobile Company was organized at the time or about the time, that Mr. Sayres commenced business in Seattle and at about the time that the change of name of the Williams Auto was made Mr. Sayres had at that time two substantial stockholders and about 1946 or '47, acquired all of the stock of American Automobile Company, that is the distributor and retailer of these cars, except one qualifying share, of which I held. And he continued to operate that company, that is American Automobile Company, there were some changes, which are not material herein, I think at one time becoming a partnership and then back to a corporation again, but finally a corporation which continued to operate as such, distributor until a few weeks ago when a sale was made of assets, in the meantime its name had been changed to Stan Sayres, Inc., but I organized both the original company, all subsequent companies, and partnerships, and the change of name and change of stock of Williams Automobile Company, and those [117]

(Testimony of Tracy Griffin.)

date back to 1932. The American Automobile Company rented the premises from the American Properties after American Properties acquired that property at Broadway and Madison.

Mr. Short: Does your Honor have further questions on that?

The Court: No.

Q. (By Mr. Short): What is your recollection as to whether or not the possibility of the government as purchaser of these high-powered boats was contemplated and discussed?

A. As I said, I heard Mr. Sayres' testimony about the Navy, they were very optimistic back in those days because that wasn't too long after they had had the experience with the PT boats in the Phillipines. I should explain one other matter perhaps in regard to these corporations. An additional reason that the, this venture did not go into American Automobile Company was primarily at that time American Automobile Company was not locally owned, there were other stockholders aside from the qualifying shares, and regular reports had to be made to the Chrysler Corporation on their forms and so forth, and if there was another side venture it would just complicate a situation that didn't require it.

Q. In reference again to this Navy question, I call your attention to the next-to-the-last sentence on page 1 of that resolution which states that, "He", referring to Sayres, [118] "believed that the government would itself be interested in the fastest

(Testimony of Tracy Griffin.)

type of boat that could be manufactured." To what does that refer?

A. Well that refers to the type of boat that Ted Jones had designed, they intended to try out, figuring that Slo-Mo IV was going to be it.

Mr. Short: Your witness.

Cross Examination

Q. (By Mr. Cromwell): Mr. Griffin, do you have a pecuniary interest in this action?

A. None except I expect to charge for per diem for services rendered when we are through.

Mr. Cromwell: That is all.

The Court: You may be excused.

(Witness excused.)

Mr. Short: Simply to correct the record, I think I made a reference to Williams Motor Company. It is actually William Auto Company, to the extent that that is an error, I wish the record to show it.

Call Mr. Munger.

ALBERT R. MUNGER

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows: [119]

The Clerk: Will you state your name and address for the record, please.

The Witness: Albert R. Munger, M-u-n-g-e-r, 4520 West Laurel Drive, Seattle.

Direct Examination

Q. (By Mr. Short): What is your occupation, Mr. Munger?

A. I am retired.

(Testimony of Albert R. Munger.)

Q. Before you retired what was your occupation?

A. I retired from the presidency of the Seattle First National Bank.

Q. When did you retire from that position?

A. On the 31st of December, 1953.

Q. In reference to other banking institutions in the State of Washington, what is the relative size of the Seattle First National Bank?

A. Well, it is by a considerable degree the largest banking institution in the state.

Q. How many branches do you operate or did you operate, when you were with them?

A. I think we had 56 at the time that I retired.

Q. In 1949 was it the largest banking institution west of Chicago and north of San Francisco?

A. I think that is true.

Q. In 1949 what was your capacity with the bank? [120]

A. In 1949 I was Chairman of the Loan Committee.

Q. And were you located at the main office?

A. I was.

Q. That is in the Dexter Horton Building in Seattle? A. It is.

Q. Are you acquainted with Mr. Sayres?

A. Well, from the time that he first engaged in Seattle which was in 1931 or '32.

Q. Is it fair to state that you are and have been his financial adviser over those years?

(Testimony of Albert R. Munger.)

A. It is, in addition to the fact that I was his banker. Yes.

Q. What I am getting at, did he consult you from time to time on the—seek your advice as to business ventures?

A. I think it is probably very true that he has not entered into any considerable business venture or decision in all these years since '32, that he hasn't consulted me if I was in the city.

Q. Did you have occasion to consult with him in reference to these unlimited class hydroplanes?

A. I did.

Q. State if you will, then, that is, when there was any discussion with you and Mr. Sayres as to any business venture connected with those boats.

Q. Without being able to specify any positive individual [121] date, I would say that it was in 1939 that our conversations first started on that subject.

Q. At that time what kind—what boat—

A. (Interrupting) Did I say '39? I mean '49.

Q. Yes. In 1949? A. Yes.

Q. Then you can strike that question I was starting to ask. Who participated in those discussions besides yourself?

A. I think at times Mr. Griffin. At other times perhaps Mr. Scott, but most frequently I think that Mr. Sayres and I were alone in our conversations.

Q. What was the general purport of Mr. Sayres'

(Testimony of Albert R. Munger.)

questions, what was his plan that he was seeking your advice about?

A. Well, so far as the business aspect of going into the manufacture and sale of boats was concerned, his question of me was my opinion on the desirability of entering into that venture as a business enterprise.

Q. And specifically doing what in a business way with the boats?

A. To make an arrangement with Ted Jones and Anchor Jensen whereby the three together would be interested in the building and the sale of boats of the type that Mr. Jones had designed.

Q. What ultimately evolved in that discussion?

A. Well, my advice to Mr. Sayres was favorable to the [122] venture, I advised him that in my opinion it was sound and promising business venture.

Q. And did you make any recommendation to him as to any corporate organization?

A. I cannot distinctly remember making any recommendation on my part, but I was a party to the discussions that involved in what ownership and in what form that business should be conducted. I had only one stipulation in respect to the base interest that he should not enter into it individually.

Q. I see. I take it from that he should either organize or select a corporation?

A. That was the effect of it.

Q. Did you ever hear the subject of the Navy mentioned or discussed in any of those conversations?

A. Oh, yes.

(Testimony of Albert R. Munger.)

Q. In what regard?

A. Well, it was one of the factors that was of importance in making up one's mind as to the desirability of the business venture, and the circumstances were that we all had in mind the experience with the P-T boats during the war with the thought that they had been extremely valuable to the Navy and that it might very well be that the Navy would become a very important customer for this business venture in the development and the purchase of the successor models of the P-T boats for use in rescue and in all other affairs where speed was the prime [123] requisite because in my opinion it was evident that a boat designed along these lines would be far speedier and more useful to the Navy than the P-T boats had been in the recently ended war.

Q. Other than the Navy and/or Coast Guard or other government user of high speed boats, what other prospective purchaser or purchasers was it anticipated would buy this type of high speed vessel?

A. Well, in my thinking there were probably a large number of prospective purchasers for these reasons, first, it was evident in our minds at least, that Ted had designs here that would just revolutionize the capacity and the construction of these unlimited hydroplanes, in the second place, he was able to build them for what seemed to me a rather modest cost, in the third place, that those people interested in owning and operating racing boats

(Testimony of Albert R. Munger.)

of this type had been accustomed to spending much larger sums for their boats, and that they would readily pay prices for these new developments that might run to two or three times the actual cost of producing the boats. In other words, it could be very profitable.

Q. Did you, when I say you, I mean your bank, the Seattle First National Bank, have any occasion to invest by loan or otherwise in this venture?

A. Mr. Sayres borrowed for the American Properties, Inc., [124] a sum of money that I think was between twenty-five and thirty thousand dollars, sometime after our conversations, and I think probably in the year 1950.

Q. Did you approve that loan or at that time were you on the loan committee, do you recall?

A. I was chairman of the loan committee, but I was not an active loan officer, that loan was made by a loan officer in one of our branches. It came before me for approval in the normal run of the bank's business.

Q. The borrower on that loan was who?

A. American Properties, Incorporated.

Mr. Short: Will you mark this.

The Clerk: Exhibit 6 for identification.

(Petitioner's Exhibit No. 6 was marked for identification.)

Q. (By Mr. Short): Handing you what has been marked for identification as Petitioner's Exhibit 6, will you identify what that document is?

A. This represents a notice of credit to the

(Testimony of Albert R. Munger.)

American Properties, Inc., dated August 7, 1950, representing a——

Q. (Interrupting) In what amount?

A. Of \$26,000, in the form of a note.

Q. That appears to be the Metropolitan Branch. Is that where the account of American Properties was carried? [125] A. That is true.

Q. Where is that branch?

A. In the White Henry Stewart Building on 4th Avenue.

Mr. Short: I will offer Petitioner's Exhibit 6.

Mr. Cromwell: We ask for production of the note referred to there, that is the best evidence of that loan.

The Court: This seems to represent a deposit with the bank in the amount of \$26,000.

Q. (By Mr. Short): Is that in fact, a deposit by American Properties or is that a bank credit to the account of American Properties?

A. That is the customary notice of credit for the proceeds of a note of borrowing.

Q. Can you now tell——

Mr. Cromwell (interrupting): I object to this, your Honor, the note is the best evidence of this, the witness has testified that he didn't of his own knowledge, make this, himself make this.

The Court: If the witness has a recollection that there was a loan made and states that this is the notation of it on the records of the bank, I think it is admissible. Does the witness know?

Q. (By Mr. Short): Do you have a recollec-

(Testimony of Albert R. Munger.)

tion that there was a loan made to American Properties and that that is Exhibit 6, the notation [126] of the deposit to the account of the borrower?

A. I think I can clearly state that that is the case.

Mr. Cromwell: You think, do you know that to be a fact? A. I didn't make the entry.

Q. (By Mr. Cromwell): Who made the entry?

A. The entry was made in the Metropolitan office of the Seattle First National Bank.

Q. Do you know that to be a fact?

A. Only by reason of this notice, and the fact that the note, that the borrowing was made in that office.

Q. But you don't know who made this——

A. (Interrupting) What particular officer or what particular clerk?

Q. Or that it was actually made other than in statement here?

A. I know by my memory that there was such a loan, that it came before me in the normal course of review of loans in my capacity as the head of the loan department.

Q. Do you know of your own knowledge that this loan was made on 8/7/50?

A. I couldn't say from my own memory that it was on that date, it was on or about that time, in that year.

Mr. Cromwell: I object to this, your Honor, it is [127] not properly identified.

The Court: I will receive it in evidence.

(Testimony of Albert R. Munger.)

(Petitioner's Exhibit No. 6 was received in evidence.)

Q. (By Mr. Short): Do you have a recollection now——

Mr. Cromwell (interrupting): Just a minute. I would like to note my exception to your ruling regarding the admission of that exhibit, which is Petitioner's Exhibit 6.

The Court: Your objection is noted.

Q. (By Mr. Short): Can you state of your own knowledge that that loan was made to the company in reference to—for use in connection with the production and maintenance of these boats as distinguished from the other function of the corporation? A. I can.

Mr. Short: I think that is all.

Cross Examination

Q. (By Mr. Cromwell): Mr. Munger, what collateral was given for this note?

A. No collateral.

Q. No collateral was given for it? A. No.

Q. Did you ever personally see the note?

A. No, it would be very improbable that I saw the note. [128]

Q. Your answer to that question is no, you did not see the note?

A. That is correct.

Q. Did you personally handle the transaction which resulted in the loan? A. No.

Mr. Cromwell: That is all, your Honor.

(Testimony of Albert R. Munger.)

Mr. Short: That is all.

The Court: I would like to ask this question of the witness.

Did you say you knew what this was to be used for?

The Witness: I knew that it was to be used for the operations in connection with the boats, because the corporation, as far as I ever knew, had no occasion to borrow otherwise.

The Court: Did you know that?

The Witness: Well, I was very familiar with its affairs on a day-to-day basis almost.

The Court: I don't suppose you know how it actually was used?

The Witness: No.

The Court: Very well, you are excused.

(Witness excused.)

Mr. Short: Call Mr. Scott. [129]

HAROLD L. SCOTT

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

Mr. Cromwell: Your Honor, I would like the record to note at this time that Mr. Harold Scott who is on the witness stand is entered as counsel of record for petitioner, American Automobile—American Properties, Incorporated, and also entered as a counsel for petitioners Stanley Sayres and Madeleine Sayres in this controversy.

(Testimony of Harold L. Scott.)

The Clerk: Will the witness please state his name and address for the record.

The Witness: Harold L. Scott.

Direct Examination

Q. (By Mr. Short): Where do you reside, Mr. Scott?

A. 8111 Blue Ridge Drive, Seattle.

Q. And your occupation?

A. Certified Public Accountant.

Q. With whom?

A. I am a partner in Pete Marwick & Mitchell.

Q. And how long have you handled the accounting affairs of the taxpayers in these three docketed cases?

A. I think I have handled Mr. Sayres' companies and his personal, since 1932, when he first started in Seattle. It might have been the latter part of '32 or early '33, I can't [130] remember exactly.

Q. Mr. Scott, do you maintain the ledgers, journals for Mr. Sayres and the various corporations in which he is interested?

A. No, sir, we do not, except in this case of American Properties, we had one of our men go up and go through all of the invoices and check and set up the opening entries in the books in 1949.

Q. All right. Were you aware before this hearing today that the respondent was challenging in this proceeding, the items of expense attributable to these boats?

(Testimony of Harold L. Scott.)

A. I did not know that he was challenging the validity of the expenditures by the corporation except to say that they were not allowable deductions of ordinary and necessary expenses of the corporation.

Q. Was that by reason of their claim that it was the hobby of Mr. Sayres?

A. Yes, sir.

Q. Are you now prepared to establish those expense items? A. Yes, I believe we are.

Q. Perhaps if you could just—you are aware of Exhibit A in evidence? You have seen that document before it was offered? A. Yes, sir.

Q. I show you what is in evidence as Exhibit A not perhaps in that form, but have you seen that breakdown of figures? [131] A. Yes.

Q. And that was prepared by whom?

A. Prepared by one of the government men.

Q. And was previously furnished to you?

A. I believe it was taken directly from our work papers.

Q. Do you need the returns to substantiate the items of expense or can you do it from what you have?

A. I think I can do it from the work papers. For the year 1949—

Mr. Cromwell (interrupting): Just a minute, your Honor, I object to the witness testifying from the books, they are not in evidence. I also object to them being put in evidence on the grounds that Mr. Scott didn't keep these records.

(Testimony of Harold L. Scott.)

Q. (By Mr. Short): What is it that you have before you?

A. I have the work papers that we have made up in our office in connection with the preparation of the '49 and the 1950 income tax returns of American *Products*.

Q. Are those work papers and the preparation of those returns under your personal supervision?

A. Yes, sir.

Q. You, in fact, signed those?

A. Yes, I did.

Mr. Short: I feel he is competent to testify.

The Court: I think not. [132]

Mr. Cromwell: The books and the records are the best evidence.

The Court: The books and records are the best evidence. However, if he had a summary here of extracts from the books and the books are in the courtroom, I think it would be admissible.

Q. (By Mr. Short): Do you have such summary?

A. The books are in the courtroom and the books have been prepared from these work sheets to the end of December 31, 1949.

The Court: The books have been prepared from this?

The Witness: Yes. These are the original work sheets that we examined invoices and/or other supporting papers for all items below.

The Court: These do constitute the original records?

(Testimony of Harold L. Scott.)

The Witness: These are the original, yes, sir.

The Court: And they were under your supervision?

The Witness: Under my supervision.

Q. (By Mr. Short): Mr. Scott, let me ask you this, too, prior to your becoming a partner in Marwick-Mitchell and Company, you operated as a sole trader doing business as Harold L. Scott and Company?

A. It was a partnership under Harold L. Scott and Company for many years.

Q. And you handled the affairs of Mr. Sayres and his [133] corporations prior to your becoming a member of Pete Marwick & Company?

A. Yes.

Q. As long as he has been in business in Seattle? A. That is correct.

Q. Do you have a personal acquaintanceship with his affairs and the affairs of his corporations?

A. Have had for many years.

Mr. Short: I submit he is qualified.

Mr. Cromwell: Your Honor, these are not the original records of the corporation.

Did you prepare these, Mr. Scott, yourself?

The Witness: No, they were prepared by James Fisher.

Mr. Cromwell: Then I object to their admission, your Honor, they haven't been properly identified, they are not original records.

The Witness: They were prepared under my supervision taken from invoices and/or other sup-

(Testimony of Harold L. Scott.)

porting papers. There were no books of the company.

Mr. Cromwell: Doesn't the corporation keep journals and ledgers?

The Witness: It didn't have at that time. They were kept in memorandum form. Mr. Miller, in examining it, I am sure, built up most of his information right from this record here. He knows what it is. Mr. Miller is the revenue agent, the [134] examiner.

Mr. Cromwell: Is Mr. Fisher available?

The Witness: He is not with our firm at this time. I think we could locate him. It might take a day, it might take two days. If we have got to go over until Monday I believe we might be able to locate him.

Mr. Cromwell: We insist on having Mr. Fisher identify these records, your Honor.

The Court: Who is Mr. Fisher?

The Witness: He is one of our staff members.

Mr. Short: In view of the fact that Mr. Scott closely enough supervised the work of Mr. Fisher to be prepared to sign the return and due to his personal acquaintanceship with Mr. Sayres' affairs, he is as qualified, if not more so, than Mr. Fisher.

The Court: You have the record now?

Mr. Short: I assume so, this is a surprise phase of the case to me.

The Court: The records that are in the court here, the permanent records of the corporation, would they show the same thing?

(Testimony of Harold L. Scott.)

The Witness: Mr. Miller has made this exhibit A from our paper.

Mr. Cromwell: That is not a correct statement. This was made by the technical adviser who did not make the examination [135] of the books and records.

Mr. Griffin: The documents supplied by the government we accepted the figures and assumed the government would accept them, on the one hand they say these items are not expense and then on the other hand they charge you the same identical items on the other side of the ledger. Now, it is technical, we can introduce all of these books if we have to, and everything there is, but why should it be done when it is the government's own figures that we are willing to accept?

Mr. Cromwell: It is just elementary that when we disallow expenses to a business as not being ordinary and necessary they have got to prove them. It is just elementary.

The Court: Of course I understand that disallowance carries with it, unless there is some qualification, a disallowance of the figures themselves, too. However, it seems to me that the parties should be able to get together and show what the books show in regard to these expenses, whether the government wants to concede that or not, we could at least show by stipulation what the books show on it.

Mr. Short: All the books are present, are they not?

(Testimony of Harold L. Scott.)

The Witness: Yes.

The Court: How much of a job would that be?

The Witness: I am sure that Mr. Miller the revenue agent, has all of the figures that were taken from the books. [136]

Q. (By Mr. Short): How long do you think in terms of time to cover the matter of these expense itmes? What do we have, two fiscal years involved?

A. We have two calendar years involved with the corporation, and it involves Mr. Sayres' on a fiscal year, October 31st, and therefore, we have got to go through the two fiscal years.

The Court: I prefer not to have testimony of a witness as to what books show. I would prefer to have some instrument purporting to be an extract from the books.

Mr. Short: What time do you ordinarily adjourn? I am just calculating as to whether the weekend is available for that kind of a summary.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Short: That concludes our proof except for the matter of the summary.

Mr. Griffin: On this phase?

Mr. Short: I think it is understood that we go into the salary question when we finish this.

Mr. Cromwell: Let them go ahead and call their witness on that, your Honor, and finish their case.

Mr. Short: We had already stipulated that we

would try this when we had concluded this case. The salary question [137] will take very few minutes. I prefer to conclude on this matter now rather than to start the salary question now, which is unrelated.

The Court: I am not sure I understand what the agreement was. Does the government care to go ahead with its side of the case? Normally the taxpayer goes ahead with its whole case.

Mr. Cromwell: I would prefer if the taxpayer should proceed.

The Court: Is there any reason that you shouldn't go ahead with your whole case?

Mr. Short: Not except that we stipulated we wouldn't but if he wants to change it I am willing.

The Court: Well, all right.

Mr. Cromwell: Your Honor, I might state if it will accommodate the petitioner, that I will proceed with the respondent's case with regard to the boat issue provided it will be stipulated that when I finish and they have finished with their cross-examination of my witnesses, that that will close that issue as far as the record is concerned, with the one exception of the stipulation of Mr. Brougham's or the deposition of Mr. Brougham, which we mentioned this morning.

Mr. Short: Do I understand you are asking me to waive rebuttal on your case?

Mr. Cromwell: No, I will conclude very quickly my [138] case regarding the boats, and you may proceed with your cross-examination regarding that and then we will close that phase of the case.

Mr. Griffin: We may have rebuttal, of course.

Mr. Cromwell: Provided it is terminated today. I can finish in perhaps the next half hour with my case.

Mr. Short: I don't want to be simple-minded, but what are you suggesting that I didn't suggest. How do we differ?

Mr. Cromwell: I want to be sure that counsel for petitioner will agree that should we proceed with the boat issue to a conclusion, that we won't come in Monday morning with rebuttal witnesses. I want the record closed as far as the boat issue is concerned if we are going to proceed in this manner.

Mr. Griffin: I may say to you now, sir, that with a statement of that kind that you are asking us to accept your witnesses without rebuttal, we will not so do. We don't know what you are going to present.

Mr. Cromwell: O.K. Put your case on then.

Mr. Short: That is what I thought you meant. I call the Court's attention that this battery of people are here on the boat issue, these last items on the Docket 57751 and 57749 and 50, relate to Mr. Sayres' salary from two corporations, the Jen-Cel-Lite Corporation and the American Automobile Company, Incorporated, now Stanley Sayres, Incorporated.

On the first of those docket numbers in reference to [139] the salary item itself, the taxpayer concedes that the salary item which is in the amount

of \$3,200 is properly assessed, but that the negligence penalty is improperly assessed.

In reference, however, to Docket 57749 and 50, the taxpayer challenges both the assessment of salary and penalty. I will cover briefly in this brief opening statement, the Jen-Cel-Lite matter. Both of these things arise on error by bookkeeping or accounting personnel in confusing the fiscal years of the individual taxpayer and the corporation paying the salary.

The Jen-Cel-Lite Corporation—well, Stan Sayres himself at all times material to this controversy and now, was on a fiscal year of October 31st as I think the record already demonstrates. In November, 1949, Jen-Cel-Lite Corporation declared and fixed Mr. Sayres salary at \$4,000 for the period July 1 to November 30, 1949. They, by that corporation by the way, is on a calendar year of November 30th. Commencing December 1, 1949, his salary was to be \$800 a month. It is readily apparent that the \$4,000 salary from July to November is likewise \$800 a month. By reason of Sayres' personal return being on a calendar—fiscal year ending October 31, it is also at once apparent that at the time that salary was declared to him his taxable year had already closed. And in fact, may well have filed his return for all I know.

The Court: Was he on a cash basis, too? [140]

Mr. Short: Yes, he individually is on a cash basis, therefore there was credited to his account in the Jen-Cel-Lite Corporation the \$4,000 salary covering a five-month period, four months of which

were in his previous fiscal year and that constitutes the \$3,200 item, and the remainder, of course, went into his next successive year which caused, when he filed his return he filed it on the basis of \$800 a month as of October 31, 1950, and failed or accountants failed to pick up the retroactive \$3,200 that happened to have fallen into his previous fiscal year, but by reason of the time of the declaration, had already been filed.

In the American Auto salary, that is not quite that simple. The American Automobile Company was on a fiscal year of April 30. Up until—at all times prior to April 30, 1948, that is, at all times material at least, Mr. Sayres' salary as president of American Automobile Company, was \$30,000 a year. On April 23, 1948 the record will show that his salary was increased to an annual salary of \$42,000 a year and that would be effective for the year ending—well, strike that. Again in that year Mr. Sayres' personal return was on an October 31st fiscal year. That resulted—when the accountant called Mr. Harry Potter, who is the treasurer of American Auto, to inquire as to the present status of Mr. Sayres' salary, he was advised correctly that his salary was \$42,000 a year. The accountant, who is Mr. Peterson, now deceased, automatically divided that [141] by 12 and posted to his account that figure which by reason of the difference in fiscal years, caused an additional thousand dollars a month to accrue to Sayres for November, December, January, February, March and April, that is, for the period between the end of his fiscal year, October

31st, and the beginning of the declaration of the \$42,000 salary, effected May 30, 1948, so that \$8,000 difference is the matter in issue.

There are two docket numbers because separate returns were filed, and there is \$3,000 on each return. The evidence will show that Mr. Sayres does not in either corporation or in any corporation, draw a monthly salary check. These are by postings to his account and drawings from the account in amounts which bear no relation to his monthly salary when the return was filed he personally did not know of the situation that is related here, your Honor, and the evidence will show that it was his intent, and the intent of the corporation, to declare him a salary of \$42,000 per year, but not more than \$42,000 in any one year, but the actual confusion is Peterson's assumption as the Court can appreciate almost without the testimony, the false notion that the fiscal year of both the corporation and the taxpayer were the same.

The evidence will also show that during that period of time when—you see, these two salaries and these two corporations are both charged to the same taxable period, but there was never any period of time in that area when the W-2 would ever agree with the actual amount received by the [142] taxpayer because of the fiscal year not coinciding not only between Sayres and American Auto, but between American Auto and Jen-Cel-Lite. So the W-2 would be no indication that there was anything amiss. And it is our contention that as far as the American Auto salary is concerned, the amount

was not actually received by the taxpayer, that the negligence penalty does not lie in the Jen-Cel-Lite case. However, 57751, we concede that despite the fact the taxpayer didn't know it, that amount was received and is, therefore, as far as the salary was concerned, is conceded, but the negligence penalty is challenged.

The Court: The negligence penalty was what?

Mr. Short: A five per cent penalty was assessed, not that item as segregated, but against the total adjusted item which I think includes the boat issue as well, the entire 1949 and '50 readjustment.

Mr. Cromwell: It includes only the salary issue.

The Court: What is that negligence penalty, failure to file an estimate or a timely return or what?

Mr. Cromwell: That is a failure to properly report your income, your Honor.

The Court: I am very glad to have that explanation. It wasn't entirely clear to me. It is rather complex, but I suppose it will clear up.

Mr. Short: The accountant can explain the manner in which the error occurred in both instances. I am not sure the [143] taxpayer can, but I will call him for the purpose of stating——

The Court (interrupting): Let us move right along, then.

Mr. Short: Call Mr. Sayres.

STANLEY S. SAYRES

having been previously sworn, was recalled and testified further as follows:

Redirect Examination

Q. (By Mr. Short): Mr. Sayres, you have previously been sworn. A. Yes.

Mr. Short: Will you mark this.

The Clerk: Petitioner's Exhibit 7 for identification.

(Petitioner's Exhibit No. 7 was marked for identification.)

Mr. Short: Will you mark this.

The Clerk: Petitioner's Exhibit 8 for identification.

(Petitioner's Exhibit No. 8 was marked for identification.)

Mr. Cromwell: Your Honor, this negligence penalty is assessed on the whole deficiency, but it specifically relates to failure to report the full amount of salary.

Mr. Short: As I understand the negligence is claimed on these items I just referred to, but it is computed on the basis of the entire returns. [144]

The Court: What is that provision of the law?

Mr. Cromwell: 293-A.

The Court: It is on the whole deficiency?

Mr. Short: Yes.

Q. (By Mr. Short): Mr. Sayres, I hand you what has been marked for identification as Petitioner's Exhibit 8 and I will ask you if that is your signature as president on those minutes?

(Testimony of Stanley S. Sayres.)

A. Yes.

Q. And that is the signature of Ralph Hanson?

A. Well, Ralph was secretary at that time.

Q. And that is his signature, is it?

A. Yes.

Q. And that is the original minutes of the meeting of the Board of Directors of American, for April 23, 1948, is it not? A. Yes.

Mr. Short: I will offer Petitioner's Exhibit 8.

Mr. Cromwell: Respondent has no objection.

The Court: It will be received in evidence.

(Petitioner's Exhibit No. 8 was received in evidence.)

Q. (By Mr. Short): Mr. Sayres, those minutes reflect that on that date, April 23, 1948, your salary was increased to \$42,000 a year? A. Yes.

Q. What was your salary prior to that time?

A. Thirty, as I recall it.

Q. You attended that meeting, I take it?

A. Yes.

Q. And would you state what the intention of you and the other directors in—as to that \$42,000 salary, as to when it was to commence?

A. Well, there was certainly no intention to make it retroactive, never a thought in the world of that.

Q. What was it that it was contemplated that you would be paid in any one year?

A. \$42,000.

Q. Do you draw, Mr. Sayres, a salary check or have you ever drawn a uniform monthly salary

(Testimony of Stanley S. Sayres.)

check, from American Automobile? A. No.

Q. How about the Jen-Cel-Lite Corporation?

A. I have drawn a regular salary check from Jen-Cel-Lite since I felt it could pay me a salary.

Q. That hasn't always been true?

A. That is right.

Q. When did you first discover that there had been appropriated to the period November, December, January, February, March and April, ending April, 1948, an additional \$1,000 a month to your salary? [146]

A. Not until Mr. Scott told me and that was long after. I can't recall just how long.

Q. Were you at any time aware that you were being credited with a salary of anything in excess of the amount stated in that resolution?

A. No, certainly I would have corrected it if I had have been.

Q. Now, in reference to, well again in the—this covers the same year in the Jen-Cel-Lite Corporation when your salary in the sum of \$800 a month was declared, when were you first aware that the \$800 for the last four months of your fiscal year ending October 31, 1948 was unreported on either your return for the fiscal year ending October 31, 1949, or October 31, 1950?

A. Well, also at the time Mr. Scott told me about it.

Q. Were you in the practice of furnishing at

(Testimony of Stanley S. Sayres.)

that time Harold Scott and Company, with the information necessary to compute your return?

A. Yes.

Q. What information did you furnish to Harold Scott and Company covering these periods?

A. Well, I imagine that it was about the standard practice, what interest I might have paid, what donations, any, well, income from dividends or anything of that nature.

Q. Do you have a recollection as to how the matter of [147] what your salary for that period was, how that was established by Harold Scott and Company and by whom in Harold Scott and Company?

A. Well, I understand this whole set of errors was made by Mr. Peterson.

Q. Did he call your office in reference to what your salary was?

A. He called and talked to Mr. Potter, so I am informed.

Mr. Short: Can I interrupt the witness a minute. Mr. Griffin, is that your signature on Exhibit 7 as secretary of the American Automobile Company?

Mr. Griffin: Yes, sir.

Mr. Short: I will offer Exhibit 7.

Mr. Cromwell: No objection.

Mr. Short: That, if the Court please, identifies the minutes for the succeeding year, and identifies the salary for the succeeding year.

(Testimony of Stanley S. Sayres.)

(Petitioner's Exhibit No. 7 was received in evidence.)

Q. (By Mr. Short): I hand you, Mr. Sayres, what will be marked for identification as Petitioner's Exhibit 9, and I will ask you if that is your signature on that document? A. Yes.

Q. And as President of American Automobile Company? [148] A. Yes.

Q. And the signature of Ralph Henson as secretary? A. Yes, that is right.

Mr. Short: May I correct the record. What I referred to as Exhibit 7 when I handed it to the Court is actually the meeting of the Board of Directors of Jen-Cel-Lite, and what will be marked as Exhibit 9 is the \$42,000 salary resolution for the year 1949.

The Court: Exhibit 7 will be received in evidence.

Mr. Cromwell: I have no objection to Exhibit 9.

The Court: Exhibit 9 also will be received in evidence.

(Petitioner's Exhibit No. 9 was marked for identification and received in evidence.)

Mr. Short: I think that is all.

Mr. Cromwell: Respondent has no questions.

The Court: You are excused.

(Witness excused.)

Mr. Short: Call Mr. Scott.

HAROLD L. SCOTT

having been previously sworn, was recalled and testified further as follows:

Direct Examination—(Continued)

Q. (By Mr. Short): Mr. Scott, your Harold Scott Company was handling the [149] returns of American Automobile Company, Incorporated, Jen-Cel-Lite and Mrs. Sayres, for the year 1949 and 1950, were you not? A. Yes, sir.

Q. Are you acquainted with the error to which I made reference in my opening statement?

A. Yes, I am.

Q. Correcting—calling your attention to the one in reference to the American Automobile Company, the salary of \$42,000 which was declared in April, 1948, would you explain in what manner those entries were made and how the returns were made up?

A. When Mr. Sayres came in to make his return for the year ended 19—October 31, 1948, he gave Mr. Peterson, who had been with me for about 25 years, he had been a very reliable man, and——

Q. (Interrupting) Let me interrupt you. Is he dead? A. Yes.

Q. When did he die?

A. He died January 23, 1953.

Q. Proceed.

A. And he received this information from Mr. Sayres as had been customary for many years, and handled the supervision of audits and tax returns for these companies. For some reason he did not

(Testimony of Harold L. Scott.)

go back to the files of the corporation to see how—see what amounts had been credited to Mr. Sayres, and overlooked [150] a credit on the books of American Automobile Company at April, 1948, of \$12,000, which was in effect giving an increase starting with November 1, 1947, through March, of \$1,000 a month. And since the company was on one fiscal basis and the individual on another, it just got overlooked as far as we can see. We cannot figure out, and whether Mr. Peterson was negligent about it. He made the mistake, there is no question about it, and I knew nothing of it until Mr. Miller, the revenue agent, called it to my attention. We have handled several hundred returns a year and with the split years and withholdings that do not agree it is a difficult thing to always catch every item.

Q. Do you know of any manner in which——

A. (Interrupting) One point I would like to make also. It was just absolutely no intent of anything, no negligence of anyone in this matter in any way, as far as I can see. We tried our best to keep our returns correct.

Q. Is there any way that you can conceive of that this matter would come to the attention of Mr. Sayres?

A. No, I do not, because he did not go to his ledgers and look to see what entries were put on. This entry of \$12,000, Mr. Peterson sent up to the company to put on the books and credit Sayres' account with the \$12,000.

(Testimony of Harold L. Scott.)

Q. That book entry does not represent actual disbursements in money to Sayres?

A. It is just journal voucher. [151]

Q. Would the W-2 issued by the corporation to the person receiving the salary either reflect or put Mr. Sayres on notice of the error that was made?

A. I don't believe so, unless a person was very familiar and checked out the withholding with the amount of salary they would not notice it. Peterson didn't notice it and the withholding was made.

Q. Well, the withholding corporations and the individuals, three of them——

A. (Interrupting) That is correct.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Q. (By Mr. Short): Your remarks in reference to absence of negligence did you mean them to apply to the other item of \$3,200 in the Jen-Cel-Lite as well?

A. Yes, I did. There is one thing that I would like to add in respect to this salary situation, that I have offered the agent and also the appellate staff the opportunity to assess the corporation disallowing the salary and let Mr. Sayres take a charge back to his account to rectify whatever damage was done by it, but I could not get any agreement.

Mr. Short: I believe that is all. [152]

(Testimony of Harold L. Scott.)

Cross Examination

Q. (By Mr. Cromwell): Mr. Scott, were you present when Mr. Peterson and Mr. Sayres talked about this matter?

A. I can't say offhand that I was. I was present many times when Mr. Sayres was in the office, whether at that time or not I can't answer that.

Q. Then how do you know what went on in Mr. Peterson's mind about this matter?

A. He discussed it with me many times.

Q. When did he discuss it with you?

A. When the agent got into the examination.

Q. Which was several years after this taxable year, is that correct?

A. I was looking at these papers and in Mr. Peterson's writing and I think it was in 1951, November 21, '51, was when I believe that the agent was in on this matter and then at that time it was discussed very thoroughly with all of us.

Q. Did you tell Mr. Miller about Mr. Peterson making these mistakes?

A. Did I tell Miller?

Q. Yes, at the time of the examination?

A. I don't remember of making any direct statement to Miller as to what mistakes Peterson had made, but I know there was a general discussion with Miller as to what had happened. What I said to Miller and what Miller said to me and whether [153] Peterson was there or not, I can't recall at this time. It is five or six years ago.

Q. When did Peterson die, Mr. Scott?

(Testimony of Harold L. Scott.)

A. January 23, 1953.

Q. Did you make the journal vouchers that corrected the amounts of salaries to Mr. Sayres?

A. Did I personally make them?

Q. Yes. A. No, sir.

Q. You stated on direct examination, I believe, that Mr. Peterson didn't go back and look at the books, is that correct?

A. Mr. Peterson did not go to our working papers in our office, our audit papers that we had made examinations of both of these companies, and he did not reconcile the deductions for salaries with Sayres' personal returns.

Q. How do you know he didn't do that, Mr. Scott? A. Because he said he didn't.

Q. Did you discuss this matter with Peterson in anyone else's presence?

A. Yes, I believe I did.

Q. Who was that?

A. I believe Mr. Sayres. I can't say positively, but the matter was an issue of a great deal of discussion and whether I discussed it with the whole office staff or just one or others, I can't answer.

Q. Mr. Scott, did Mr. Sayres ever tell you that if the negligence penalty was assessed in this case that you would have to pay it?

A. Well, he said——

Q. (Interrupting) Yes or no, Mr. Scott?

A. I don't think he said it in exactly that way.

Q. How did he say it?

A. That is what I was trying to explain to you.

(Testimony of Harold L. Scott.)

I think that Sayres felt very definitely there was neglect in our office, that it should have been picked up, and Peterson did not do what he should have done.

Q. Did you supervise Peterson's work, Mr. Scott?

A. Well, Peterson was a partner with me, and I depended upon him a great deal.

Q. Did you supervise his work, Mr. Scott?

A. Oh——

Q. (Interrupting) Yes or no.

A. I can't answer it yes or no. Because it isn't possible. Some of his work, yes, I did very carefully supervise it, other things would happen that he would take charge of and do.

Q. Did you supervise his work with respect to this salary matter of Mr. Sayres? A. No.

Q. You did not?

A. No, I knew nothing of it at all. [155]

Q. Did you advise Mr. Peterson that if you had to pay the negligence penalty that he in turn would have to pay it? A. I did not.

Mr. Cromwell: That is all.

Redirect Examination

Q. (By Mr. Short): Was Peterson a certified public accountant? A. He was.

Q. And was he a partner of yours?

A. Yes, sir.

Q. For how long a period of time?

A. Almost 20 years.

(Testimony of Harold L. Scott.)

Q. Was he normally a reliable, accurate, certified public accountant?

A. He had been for many years.

Q. Did you have confidence in him?

A. I had a great deal of confidence in him.

Mr. Short: That is all.

Mr. Cromwell: No questions.

Mr. Short: That is the petitioner's case, with the exception of this summary, this summary of Mr. Scott's.

Mr. Cromwell: I think, your Honor, that is probably a logical point to stop.

The Court: Off the record.

(Discussion off the record.) [156]

The Court: On the record.

Mr. Cromwell: I think that respondent, in the next few minutes, can proceed with his case on this boat issue and some of these witnesses are being inconvenienced by being here, your Honor.

Call Mr. Ted Jones, please.

Mr. Short: Subject to the summaries to be made by Mr. Scott for the respondent and subject only to the brief testimony of Mr. Harry Botter on Monday in reference to a telephone call from Peterson, subject only to those two items, the petitioner will rest at this time.

The Court: Will the government go ahead with its case?

Mr. Cromwell: Yes, your Honor.

TED JONES

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address, please?

The Witness: Ted Jones, 4624 South 170th, Seattle.

Direct Examination

Q. (By Mr. Cromwell): Mr. Jones, what is your business? A. Boat designer.

Q. How long have you been in that business?

A. Earlier it was merely a hobby from 1927, and the last few years it has been my business.

Q. Do you know Stanley Sayres, the petitioner in this case? A. Yes.

Q. How long have you known Stanley Sayres?

A. I think since 1939.

Q. Did you ever design any boats for Mr. Sayres? A. Yes.

Q. What boats did you design?

A. Slo-Mo-Shun III, IV and V.

Q. Did you also build those boats?

A. I built No. III in my basement at home——

Q. (Interrupting) The entire boat?

A. Up to the deck, the bottom and the stanchions which were vital to the speed and performance of the boat, I built those in my home, and the rest of it was done out at Jensen's, the engine installation and the deck and cowlings.

Q. Did you build Slo-Mo-Shun IV or V?

(Testimony of Ted Jones.)

A. Not IV, I engineered No. IV, but I built No. V with the assistance of two, and sometimes three, of Mr. Jensen's boat builders.

Q. Was Slo-Mo-Shun IV entirely your design?

A. Yes, it was.

Q. Was Slo-Mo-Shun V entirely your design?

A. Yes, it was.

Q. These were unlimited hydroplanes?

A. Right.

Q. Have you had occasion to design other unlimited hydroplanes for anyone?

A. Yes, I have.

Q. Will you state briefly who they were?

A. I designed the Breathless for J. Murphy and Miss Thriftway for the Associated Grocers, and the Rebel Suh and Gail VI.

Q. Have you ever designed any boats for Mr. Henry J. Kaiser?

A. I have designed him a hull which is under construction at this time. Also the Wahoo for Bill Boeing, Jr.

Q. Is that Boeing of Boeing Aircraft?

A. Right. And the Shanty for W. T. Wagner of Phoenix, Arizona, and a spare hull for the two of them, and I have redesigned the Gails, Such Crust, Temple, the Supertes.

Q. Who owns the Temple?

A. Guy Lombardo.

Q. And who owns the Gails?

A. Joe Shaneth.

Q. And the Such Crusts?

(Testimony of Ted Jones.)

A. Jack Shafer.

Q. Of what is Mr. Shafer? [159]

A. Detroit.

Q. Have you ever been written up in any national magazines?

A. A good many times, yes.

Q. Will you tell us for instance, which ones?

A. Well, the last——

Q. (Interrupting) Just the ones that come to your mind at this time.

A. In Sports Illustrated and in True and in Yachting, Motor Boating, Sea, Pacific Motor Boat, a good many others I don't recall.

Q. Are you a member of the American Power Boat Association? A. I am.

Q. Are you a member of the American Power Boat Association as an owner or as a driver?

A. Owner and driver.

Q. What is the—do you own an unlimited hydroplane that you race?

A. I have a half interest in Rebel Suh.

Q. Have you raced that boat in any Gold Cup races?

A. No, I haven't, I had it raced this last year by Colonel Shay, I was too busy to drive it.

Q. How long have you been a member of the American Power Boat Association? [160]

A. I think since 1934 or '35.

Q. I hand you Petitioner's Exhibit 5, which is entitled, "Propeller, American Power Boat Association, 1956 Rule Book." Will you examine that

(Testimony of Ted Jones.)

and tell me if that rule book is the same that is the rule book, assuming they had a rule book in 1950, is that the same as that?

A. It is the same size, it has the same prefixes here.

Q. To your knowledge do you know if the rules have changed between 1950 and 1956, the American Power Boat Association rules?

A. Oh, the rules change constantly in some small amounts.

Q. So the rules according to this book, would not necessarily be the rules according to the book that was issued in 1950?

A. Not necessarily.

Q. Or 1949, for instance?

A. No, they change with the boats and the speeds and conditions.

Q. I hand you Petitioner's Exhibit 1, which is entitled "Agreement", dated July 17, 1950, and I refer you to page 2, is that your signature?

A. It is.

Q. Will you explain just what, under what conditions you signed this contract?

A. Well, it turned out that—— [161]

Mr. Short (interrupting): I object to the materiality of this. It is a pretty broad answer by the witness. I don't know whether the witness understands the question.

Mr. Cromwell: I will rephrase the question.

Q. (By Mr. Cromwell): Did you sign this contract on July 17, 1950? A. Yes, I did.

(Testimony of Ted Jones.)

Q. Under what circumstances did you sign this contract, Mr. Jones, on July 17, 1950?

A. I was in Mr. Sayres' office.

Q. Here in Seattle? A. Yes.

Q. Have you ever built any boats under this contract?

A. I built Slo-Mo-Shun V, I started the boat in February, the latter part of February, in 1951, so apparently—and that was signed in '50. Oh, yes, I did.

Q. You have no other agreement for building that boat, Slo-Mo-Shun V?

A. No, other than an oral stated agreement.

Q. How long did you operate under this contract, Mr. Jones?

A. Until, I think it was the first part of November of 1951. It might have been the latter part of October.

Q. Was that after you finished the Slo-Mo-Shun V?

A. Oh, yes, and after we had campaigned it for the year [162] of 1951.

Q. Why didn't you build other boats under this contract for Mr. Sayres for the parties of the first part?

A. It would have been for Mr. Sayres had he wanted any more. And we just completed No. V by the end of July, 1951, and that took care of the racing season for that year, and no other boats were discussed.

(Testimony of Ted Jones.)

Q. Was that built—was Slo-Mo-Shun V built for the, to go into the Gold Cup race in 1951?

A. That was our deal, yes, to get it completed and running for the 1951 Gold Cup.

Q. Did you build any other boats while this contract was in effect for anybody else?

A. No, I didn't.

Q. Why didn't you, Mr. Jones?

A. I felt obligated to it, if I had signed it, then, I was going to carry through with it.

Q. Did you not build any more boats under this contract because of some disagreement with Mr. Sayres?

A. Well, the boats would have to have been built for Mr. Sayres and he didn't need any more at that time. I didn't design them for anyone else, then, until I think January of 1954, I let almost three years or roughly three years, go by.

Q. Did you have an opportunity to build boats for anyone else?

A. Oh, a good many. [163]

Q. Were you approached?

A. Yes, I was.

Q. And why didn't you build those boats?

A. Due to the restraint of the contract.

Q. Then you considered that a restraining contract?

A. I feel that it is, yes, or was.

Q. Can you mention some of the people who approached you to build boats during the period of this contract, during the period this contract was in effect?

A. Howard Keck of Los Angeles, President of

(Testimony of Ted Jones.)

Superior Oil Company, and Mr. Horace Dodge, Jack Shafer, Joe Shaneth, Gordon Thompson of Canada, two other men in Canada whose names I don't recall. There were others whom I can't remember at this time.

Q. Did you approach Mr. Sayres and ask him if you could build those boats?

A. I did in July of 1950, July 21st or 24th, right after the Gold Cup race. Horace Dodge wanted two boats built at that time for a very good figure.

Q. What was that figure?

A. \$50,000 per boat.

Q. What did Mr. Sayres tell you?

A. That we wouldn't be building for anyone.

Q. Did he tell you why?

A. Well, I would have to assume so that there would be [164] no more boats in Slo-Mo-Shun's speed and maneuverability for competition. That was what I gathered from the conversation.

Q. Now, considering the physical structure of the Slo-Mo-Shun IV and Slo-Mo-Shun V, could these boats be used on rough water?

A. Yes, for their size they are exceptionally seaworthy and built very sturdily for rough water usage. You might define how rough.

Q. Such water that perhaps as the Navy would use them in an open sea, as P-T boats would be used.

A. Not under the 28-foot length of the hulls, but if the length of the hulls were stretched out to

(Testimony of Ted Jones.)

possibly 50 feet, they would be as seaworthy as any 50-foot conventional designed P-T boat.

Q. How long is the Slo-Mo-Shun IV-

A. Twenty-eight foot.

Q. How long is the Slo-Mo-Shun V?

A. Twenty-eight foot also. The only difference between the two is their width, Slo-Mo V is seven inches wider.

Mr. Cromwell: Respondent has completed his direct examination.

Cross Examination

Q. (By Mr. Short): Mr. Jones, I take it that when you and Mr. Sayres signed this agreement, Exhibit 1, you were anticipating what [165] would happen in the event of a sale either of the boats of the design or of the class that you had designed, or of the plans for those boats, were you not?

A. Yes.

Q. That is the arrangement provided for for you in that agreement? A. That is right.

Q. Did you and he anticipate that that might be a likelihood, that is to say, that the design may be in demand for boats produced——

A. (Interrupting) My entire life has been devoted to come up with something extremely fast in the water, and I was very sure that when it was proven that it would finally pay off?

Q. And be profitable? A. Right.

Q. And you ultimately have made that your career, have you not? A. That is right.

(Testimony of Ted Jones.)

Q. And these boats that you have referred to as being designed by you for various people throughout the country are on this principle of the IV and V, are they not? A. Yes, they are.

Q. And at the time that that design was perfected in IV and V, it was a revolutionary design in reference to the [166] construction of unlimited hydroplanes which preceded it, is that right?

A. As far as the unlimited, yes, but it was identical to my limited boats that I had been racing for a good many years.

Q. You were interested and prompted, I take it, by, and are now, are you not, by profit incentive as well as a natural interest in the subject, are you not? A. Yes.

Q. Do you now make your living or is your income now solely derived from this pursuit?

A. It is.

Q. You have indicated that on July 24, 1950, it was suggested to you—it was suggested by you to Sayres, that you had available the offer to construct two such boats for \$50,000 each?

A. Right.

Q. The contract, Exhibit 1, was signed seven days before that? A. Yes, it was.

Q. Is there any relationship between those two instances? A. What?

Q. I mean is it pure coincidence that on July 17th you signed the contract to build boats exclusively for the American Properties and Sayres, and on July 24th you were asking permission [167] to

(Testimony of Ted Jones.)

build them for someone else, is there any coincidence there?

A. Yes, there is. The Gold Cup race was on July 22nd, and the concensus of opinion of all eastern boat owners and drivers was that the Slo-Mo-Shun couldn't survive the water, and the supreme test for the boat would come during the Gold Cup race, and it came through in very fine shape and immediately I was besieged with these persons wanting duplicate boats.

Q. And as a matter of fact, before that—well, before IV set the record in January of that year, there was a good deal of derision about this hull design, was there not? A. Yes.

Q. That it was a back yard freak of some kind?

A. That is what we liked to call it.

Q. The Detroit people? A. Yes.

Q. In August of 1949 is it a fair statement to say that at least you and Sayres, possibly Jensen at that time, were quite enthusiastic that this design was going to do something remarkable?

A. I was convinced.

Q. Had you convinced Sayres, too?

A. I think I had.

Q. Without getting into the detailed matter isn't it a fact that, Mr. Jones, that prior—that certain differences developed between you and Anchor Jensen? [168]

A. That is true. He had never built or raced a race boat before, he was a very fine cruiser and sailboat builder and his preference was for the old

(Testimony of Ted Jones.)

type single step or double-step hydroplane, and he constantly told me that——

Q. (Interrupting) I don't care about the subject matter. I just am curious about the fact as to whether or not there was a certain difference between you and him? A. Yes, there was.

Q. Had that progressed—that got worse over a period of time, did it not?

A. Yes, he wanted the boat heavy and I wanted it light.

Q. Was there a draft of an agreement prepared preceding this Exhibit 1, that you ultimately signed which had Anchor in it? A. Yes, there was.

Q. And I take it that was not executed by all parties?

A. I don't understand that question.

Q. By all of the parties, that is you and Anchor and Mr. Sayres, on behalf of American Properties, did not sign that agreement that had you all in it?

A. No, no, I didn't sign it.

Q. When did you go east, did you say—well, state it again, will you?

A. When did I go east?

Q. Yes. [169] A. To race the Gold Cup?

Q. No, when would you say that you parted company with American Properties and Sayres and Jensen and went on your own?

A. I think it was around the first of November, 1951.

Q. Can you state what the rule of the American

(Testimony of Ted Jones.)

Power Boat Association was in 1949 as to ownership and entry? A. No, I can't.

Q. You can't state, then, whether Exhibit 5, those rules you looked at, insofar as Rule 3 is concerned, pertaining to ownership and entry of unlimited class boats, whether that is now the same as it was in 1949?

A. I couldn't tell you.

Mr. Short: I think that is all.

Mr. Cromwell: Respondent has no further questions.

The Court: Thank you. You are excused.

(Witness excused.)

Mr. Cromwell: Respondent rests so far as this phase of the case is concerned, concerning the boat issue.

Mr. Short: Mr. Sayres, will you take the stand for a brief moment, please.

STANLEY S. SAYRES

called as a witness in rebuttal on behalf of the petitioner, having been previously sworn, testified further as follows:

Mr. Cromwell: Pardon me, your Honor, I think we can excuse all of the witnesses except perhaps Mr. Jones, and [170] I ask Mr. Jones to remain for just a few minutes.

Direct Examination

Q. (By Mr. Short): Mr. Sayres, are you ac-

(Testimony of Stanley S. Sayres.)

quainted with whether or not the rule on ownership and entry has changed since 1949?

A. No, it is exactly the same as it was.

Q. Would you state whether or not—well, I better hand you the exhibit. I show you Exhibit 1, and direct your attention to paragraph 8, which is on the end of that agreement. I will ask you whether or not the notice provided for therein was ever given either by you to Jones or by Jones to you?

A. No.

Q. I didn't hear your answer.

A. No.

Mr. Short: That is all.

Mr. Cromwell: No questions.

The Court: You are excused.

(Witness excused.)

Mr. Short: That is the end of rebuttal.

The Court: Do both parties rest except for the reservation that we had in the record a half hour ago?

Mr. Short: That is correct.

Mr. Cromwell: That is right.

The Court: Is it possible?

Mr. Short: May I suggest, if the Court please, I am [171] advised by Mr. Scott that he consulted with the respondent about getting together with the respondent at 8:30 on Monday morning and in approximately an hour and a half they could conclude and have something ready in which case I would suggest that we commence at 10 o'clock if that meets with your views on it.

Mr. Cromwell: That is satisfactory as far as respondent is concerned.

The Court: There were three things, there was the matter of this exhibit to be prepared from the records, the matter of the testimony of the one witness, and the—something about a deposition.

Mr. Short: I doubt you want a deposition.

Mr. Cromwell: No, no.

Mr. Short: Royal Brougham articles are all in now.

Mr. Cromwell: They are in, your Honor.

Mr. Short: So there are just those two items to complete the proof.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

We will recess until 9:30 Monday morning.

(Whereupon, at 5:30 o'clock p.m., an adjournment was taken until 9:30 a.m. Monday, April 21, 1956.) [172]

* * * * *

Court of Appeals, U. S. Courthouse, Seattle, Washington, May 21, 1956.

* * * * *

The hearing in the above-entitled matter was convened at 9:30 a.m. before

The Honorable Craig S. Atkins, Presiding.

Appearances: Kenneth B. Short, Esq., and Tracy Griffin, Esq., and Harold L. Scott, Esq., on behalf of the Petitioner. Gordon M. Cromwell, Esq., on behalf of the Respondent.

Proceedings

The Clerk: We will proceed with the case on trial, Docket 57748, American Properties, Incorporated, and related cases.

Mr. Cromwell: First, your Honor, I would like to say that I neglected to ask the Court Friday for permission to withdraw original exhibits put in by the Respondent and substitute photostats, and I now make that request.

The Court: Any objection?

Mr. Short: No. I wonder if the Petitioner may do likewise? We have our original resolution.

The Court: That is agreeable with you?

Mr. Cromwell: That is agreeable.

The Court: Originals may be withdrawn and photostatic copies submitted of all the exhibits that you want to substitute.

Mr. Cromwell: A dispute arose Friday with regard to the expenditures, the amounts paid by the corporation, American Properties, Incorporated, in 1949 and 1950, on the building, maintenance and operation of these boats.

We have gotten together briefly this morning, and the Respondent is now willing to stipulate that it agrees that the amounts shown on Respondent's Exhibit A, which is entitled, "Reconciliation of Expenses disallowed in computing net income of American Properties, Incorporated, for calendar years 1949 [176] and 1950, and included as additional income to Stanley S. and Madeleine A. Sayres, in fiscal years ended October 31, 1949 and 1950."

That exhibit, so entitled, at the bottom carries a summary entitled, "Adjustments to income of Individuals." The totals of those columns are the amounts that the Respondent is willing to stipulate were expended by American Properties, Incorporated, the tax years 1949 and 1950, respectively, in the building or maintenance and operation of the boats in question.

For the purposes of the record, I will stipulate those amounts.

The total amount expended by American Properties, Incorporated, in 1949, as shown by Exhibit A, is \$16,401.51. The total amount expended by American Properties, Incorporated, for 1950, is \$16,595.31. It is these two amounts which Respondent now stipulates were expended by American Properties, Incorporated, in the respective years, in the building or maintenance and operation of the boats in question.

The Court: Is that agreeable with counsel for the Respondent?

Mr. Short: Yes, sir, it is.

Mr. Cromwell: I have one witness to call on the salary question, unless Petitioner——

Mr. Short (interrupting): I still have, you know, [177] Mr. Potter, and, as I indicated to the Court, I have a couple of minutes with him. I don't know whose move it is. I have forgotten the status, whose case it is.

Mr. Cromwell: You may proceed.

HARRY POTTER

was called as a witness by and on behalf of the petitioner, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you please state your name and address, Mr. Witness?

The Witness: Harry Potter, 1715 North 107th Street, Seattle 33.

Direct Examination

Q. (By Mr. Short): What is your occupation, Mr. Potter?

A. Office manager and treasurer, American Automobile Company.

Q. How long have you been in that capacity?

A. Well, office manager since 1941, treasurer since about '47, I believe.

Q. Did you ever have a request from a Mr. Peterson of Harold Scott & Company for information relative to Sayres' salary with American Auto for 1949? A. Yes.

Q. Do you have a recollection as to when that call was [178] made?

A. Not definitely. It was at the time when Mr. Peterson was preparing Mr. Sayres' return for his '49 year, it ended October 31, 1949, and it was sometime after that, I don't know just when it was.

Q. Do you recall what the request was?

A. Yes. Mr. Peterson called and asked, or told me, that he had all of the data necessary to complete Mr. Sayres' return except his salary, and

(Testimony of Harry Potter.)

would I please tell him what the salary was, which I did.

Q. What did you tell him?

A. \$3,500 per month.

Mr. Short: That is all.

Mr. Cromwell: No questions.

(Witness excused.)

Mr. Short: Mr. Sayres.

STANLEY S. SAYRES

recalled as a witness by and on behalf of the petitioner, having been previously sworn, testified further as follows:

The Clerk: Mr. Sayres has already been sworn.

Redirect Examination

Q. (By Mr. Short): Showing you what has been admitted in evidence as Respondent's Exhibit A, I will ask you whether or not you personally supervise the expense of the construction and maintenance [179] and operation of Slo-Mo-Shun?

A. Yes.

Q. Are you acquainted with the figures that appear on that exhibit? A. Yes.

Q. Are the items of capital expenditure, maintenance and operation of those boats——

Mr. Cromwell (interrupting): Your Honor——

The Court: (interrupting): Finish the question.

Q. (By Mr. Short): ——each of them necessary and reasonable expenses for the construction and operation of the boat?

(Testimony of Stanley S. Sayres.)

Mr. Cromwell: If we are going into that evidence, we will have to put the books and records into evidence, so I will have a chance to cross-examine the witness on them. I haven't stipulated to the records, I have stipulated to the total amounts.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

As I understand the government's contention, it has disallowed these expenses as ordinary and necessary expenses of the corporation, and that probably the burden is on the taxpayer to show that they are. The present question calls for a conclusion of the witness which may be of vital help to [180] the Court in deciding that. However, I am willing to take his statement. I therefore overrule the objection, but I would suggest that you might want to fortify it for the purposes of clarifying the record on the reasonableness of these expenses.

Mr. Cromwell: Respondent notes an exception to that ruling, your Honor.

The Court: The exception will be noted.

Q. (By Mr. Short): Will you answer the question now, Mr. Sayres.

A. Well, yes. Should I answer it in my own way?

Q. Yes.

A. The expenses certainly are ordinary and necessary if we were going to accomplish anything.

(Testimony of Stanley S. Sayres.)

When you build a boat, you either have to have the engine right and the gear box right, and the struts right, and rudder has to be right, and the steering system, or the boat's a failure, and certainly there is no expense that went into that picture, neither at that time nor since, that was anything but very necessary, very much a part of the operation of the boats.

Q. Did actually more items of expense go into the boat than appears on that exhibit?

Mr. Cromwell: That is a leading question. I object to that question, your Honor.

The Court: Do you withdraw it?

Mr. Short: Yes. [181]

Q. (By Mr. Short): Do you have Exhibit A before you now, Mr. Sayres? A. Yes.

Q. In reference to that item A, "Gasoline and oil"? A. Yes.

Q. Did you use regular gasoline as you buy at a gas station? A. No.

Q. Without getting into the chemical specifications, did you make special arrangements to procure that?

A. Yes, at that time, that is, that is what was called 115, 140 octane, and I arranged to get that through Standard Oil Company this year, or these two years.

Q. This item appearing as "Travel expenses", about six or seven items down, do you see that?

A. Yes. That was the cost of taking the crew to Detroit preparatory to running the 1950 Gold

(Testimony of Stanley S. Sayres.)

Cup race. It also involved bringing the crew back home from Detroit, and then returning a little over a month later to run the Harmsworth.

Q. Same crew? A. Same crew.

Q. How many people did that consist of, on that move? A. I had six men.

Mr. Short: That is all. [182]

Recross Examination

Q. (By Mr. Cromwell): What is your definition of "Ordinary and necessary expense"?

A. My definition is the things you had to do to make it successful.

Q. What successful? A. The boat.

Q. In what respect?

A. Well, it's pretty much a matter of record, it set a world straightaway record, it won the Gold Cup and it won the Harmsworth that year.

Q. Regarding the travel expense question, you have Exhibit A there before you? A. Yes.

Q. I wonder if you will tell us there in that first column, what the \$5,229.27 represents. Just how much does that represent, as far as hotel bills are concerned, for instance?

A. In hotel bills, the crew and myself were in Detroit, I think, about roughly seven days at the time of the Gold Cup race, and I think we were there perhaps eight days at the time of the Harmsworth, and if you take six men, plus my own, as I recall it, we paid the Whittier Hotel rates around

(Testimony of Stanley S. Sayres.)

\$10 or \$12 a day, that was about, and I had to feed them, of course, so that would take quite a bit.

Q. To what extent does this represent train fare? [183]

A. Whatever the, they all, as I recall it, they all went to Detroit by air, and the over-all expense was lessened a little by one or two of them driving a new car back.

Q. What was the dollar figure expended in transportation?

A. Let's put it this way, as I recall it, the one-way airplane fare from here to Detroit is around \$130, I may be wrong in that, but it's somewhere in that general neighborhood, and some of them had a round trip, and, mind you, there's two trips involved, they went to Detroit and returned to Seattle, and then to Detroit again, and they had to come back, so I think there is a sum running in there around a thousand and two hundred dollars, perhaps.

Q. Did you take Mrs. Sayres with you?

A. Yes, I did.

Mr. Short: I would like this marked.

The Clerk: Exhibit 10 for identification.

(Petitioner's Exhibit 10 was marked for identification.)

Q. (By Mr. Short): Mr. Sayres, I am handing you what has been marked for identification as Petitioner's Exhibit 10. In reference to the last question asked you about Mrs. Sayres, can you tell us what that exhibit is? A. Oh—

(Testimony of Stanley S. Sayres.)

Q. Is that your handwriting? [184]

A. Yes, it is.

Q. What is that sheet supposed to be?

A. Gold Cup expense paid by personal check, here and there, I wrote my personal check, and then it was charged back to the company. The last item, air travel expense. Mrs. Sayres charged to S. S. Sayres personally.

Mr. Cromwell: Will you put that in evidence?

Mr. Short: Exhibit 10, I offer Exhibit 10.

Q. (By Mr. Cromwell): Did you prepare this?

A. Yes.

Q. When did you prepare it?

A. I couldn't answer that right now. I don't know.

Q. Was it made at the time that these expenses were incurred?

A. Well, undoubtedly after I returned.

Q. But not at the time the expenditures were made?

A. Let me see it again, please. That was made immediately after the Harmsworth race, that finished up on 8-2.

Q. Immediately after the Harmsworth race?

A. Yes.

Q. 8-2, what, 1950? A. 1950.

Q. And when was the Gold Cup race?

A. July 22nd. [185]

Mr. Cromwell: Your Honor, Respondents object to Petitioner's Exhibit 10 marked for identifi-

(Testimony of Stanley S. Sayres.)

cation, on the basis it wasn't made contemporaneous with the occurrence of the expenditures.

The Court: I don't think it has been offered, has it?

Mr. Short: I offer it now, yes. I offer it for the purpose of showing that it is a directive to someone who maintains the records. It's for the last entry on that sheet, directing—or last two entries, directing that the expense of Mrs. Sayres' flight to Detroit and back be charged to S. S. Sayres individually, and not to either American Auto or American Properties.

Mr. Griffin His expenses were charged to American Auto.

Mr. Short: Yes.

You see, in the entry before that, it charges his own flight to American Auto, and not to American Properties.

The Court: Show me that, will you, please?

Mr. Short: This is Mrs. S. S. Sayres to S. S. Sayres personally, S. S. Sayres to American Auto, and the rest is to American Properties, Inc. It's in reference to the question asked him by counsel whether or not Mrs. Sayres went with him, leaving the inference that that got charged to American Properties.

The Court: As I understand it, Mr. Sayres, you made [186] this within what time after you, after the expenses were incurred?

The Witness: Oh, just about as soon as I got

(Testimony of Stanley S. Sayres.)

home, shortly after I got home, I picked those right out of my personal check book.

The Court: Do you know of your own knowledge that Mrs. Sayres' expenses were charged to you personally?

The Witness: Yes.

The Court: I should think that your word would be sufficient on that.

I will receive this as being contemporaneous.

Objection overruled.

(Petitioner's Exhibit 10 was received in evidence.)

Mr. Cromwell: No further questions.

Mr. Short: I have a few more brief questions for Mr. Sayres.

Redirect Examination

Q. (By Mr. Short): In 1950, Mr. Sayres, you then had—will you state again, so we get ourselves oriented, when the Slo-Mo-Shun V was built?

A. No. V was built in 1951.

Q. In 1950 there was in existence Slo-Mo-Shun III and IV? A. That is right. [187]

Mr. Cromwell: That is a leading question.

Mr. Short: Without establishing the dates.

Q. (By Mr. Short): What boats did you have in existence in 1950?

A. Slo-Mo-Shun III and Slo-Mo-Shun IV.

Q. At that time what was the life expectancy of Slo-Mo-Shun III?

A. Well, many race boats are pretty well done

(Testimony of Stanley S. Sayres.)

up within two years. I felt both these hulls were of very sound construction, and it was my own opinion they were good for at least four years.

Mr. Short: That is all.

The Court: You are speaking of the physical life?

Mr. Short: Physical life, yes.

Let me put it this way.

Q. (By Mr. Short): The life of the boats for the use to which they were put was how long? Is that your answer?

A. Yes, that is what I mean.

Recross Examination

Q. (By Mr. Cromwell): Do you mean their racing life, Mr. Sayres? A. Yes.

Mr. Cromwell: That is all.

Mr. Short: That is all.

We rest. [188]

(Witness excused.)

Mr. Cromwell: I would like to call Mr. Miller, please.

GEORGE MILLER

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: Please state your name and your address.

The Witness: My name is George Miller, 5717 37th Avenue Northeast, Seattle.

(Testimony of George Miller.)

Direct Examination

Q. (By Mr. Cromwell): What is your occupation?

A. I am an internal revenue agent.

Q. How long have you been an internal revenue agent? A. Nine years.

Q. During your course of employment as an internal revenue agent did you ever have the occasion to examine the records of Stanley S. Sayres and Madeleine A. Sayres? A. Yes, sir.

Q. For what years?

A. The fiscal years ending 10/31/48, 10/31/49, 10/31/50.

Q. Was that in connection with an examination of their income tax returns for those years?

A. Yes.

Q. Did your examination include the examination of any [189] books or records of any corporations? A. Yes, sir.

Q. What corporations?

A. The American Properties, Incorporated, and the American Automobile Company.

Q. Were those corporations of Mr. Sayres'?

A. Yes, sir.

Q. Did you examine the pay roll records of American Automobile Company for the year 1948 to determine what salaries, if any, were credited to Mr. Sayres during his taxable year 1948?

A. Yes, sir.

Q. Did the pay roll records of American Auto-

(Testimony of George Miller.)

mobile Company disclose any salary credited to Stanley Sayres in his tax year 1948?

A. Yes, sir.

Q. How much? A. \$48,000.

Q. Did the record of American Automobile Company disclose any income taxes withheld on salary credited to Stanley Sayres in his tax year 1948? A. Yes, sir.

Q. Did you transcribe the pay roll records of American Automobile Company by month as to salaries credited to Stanley Sayres during the tax year 1948? A. Yes, sir. [190]

Q. Did you also transcribe from the pay roll records of American Automobile Company month by month as to income taxes withheld on those salaries credited to Mr. Sayres in 1948?

A. Yes, sir.

Q. Have you had a copy typed, that was prepared from that transcription? A. Yes, sir.

Mr. Cromwell: I would like this marked, please.

The Clerk: Exhibit W for identification.

(Respondent's Exhibit W was marked for identification.)

Q. (By Mr. Cromwell): I hand you Respondent's Exhibit W marked for identification and ask you if that is a typed copy of the transcriptions of the payroll records, made by you from American Automobile Company's books, of Mr. Sayres' salary for his taxable year 1948? A. Yes, sir.

Q. Does it also include other taxable years?

A. Yes, it does.

(Testimony of George Miller.)

Q. Does it include the years 1946 through 1950, inclusive? A. Yes, sir.

Q. Referring to page 2 of Respondent's Exhibit W marked for identification, I ask you what that is, Mr. Miller.

A. It's a recapitulation of the amounts taken as income tax withheld on Mr. Sayres' return.

Q. What is the bottom of this?

A. It's a reconciliation between the income tax withheld records of the American Automobile Company, and that as reported on the returns of Mr. Sayres and Mrs. Sayres.

Mr. Cromwell: I offer Respondent's Exhibit W, marked for identification, in evidence, your Honor.

Mr. Short: No objection.

The Court: It may be received.

The Clerk: Exhibit W.

(Respondent's Exhibit W was received in evidence.)

Q. (By Mr. Cromwell): Handing you Respondent's Exhibit W, Mr. Miller, referring to November, under the schedule 1947, referring to the heading, "1947" and down in the second column, or in the second portion, of page 1 of that exhibit, under, "Salaries", for the months of November and December, 1947, the total amount of \$5,000, credited to Mr. Sayres' salary account, is that what you found to be credited to his account?

A. That is correct.

Q. On the salary account?

A. That is correct.

(Testimony of George Miller.)

Q. On the books of American Properties, Incorporated? A. Yes, sir.

Q. Referring to the next column, under "1948", the bottom [192] of the column says, "\$43,000". Will you tell the Court what that represents?

A. The \$43,000 represents the salary credited to Mr. Sayres' account from January 1, 1948, to October 31, 1948. It's for the months of January to October, inclusive.

Q. How many months is that, in that period?

A. Ten months.

Q. Referring back to the months of November and December, 1947, where the total amount you found credited to Mr. Sayres' salary is \$5,000, \$5,000 plus the \$43,000 is how much?

A. \$48,000.

Q. You found that total amount credited to Mr. Sayres' salary account? A. Yes.

Q. For 1948, on the books of American Properties?

A. For the fiscal year ending 10/31/48.

Q. In that same column, on Exhibit W, opposite the month of "April" is an item of "\$12,000". Will you explain to the Court what that is?

A. That represented an additional entry to the books of \$12,000 covering salary, which is a part of the \$43,000. It is represented in a journal voucher.

Q. When did you find that was credited to Mr. Sayres? A. As of April 30, 1948.

Q. Did you find from your examination of the

(Testimony of George Miller.)

pay roll [193] record of American Automobile Company a deduction for income tax withheld on that \$12,000 item just referred to?

A. Yes, I did.

Q. What, how much was the credit for the tax withheld on that amount? A. \$1,800.

Q. Referring to page 2 of Respondent's Exhibit W, which is a recapitulation of the figures on the first page, under the heading, "Total amount withheld, \$7,459.80", does that include the \$1,800 on the \$12,000 item? A. Yes.

Q. In examining the separate tax returns of Stanley and Madeleine Sayres for 1948, did you find that between them they had taken full credit for income taxes withheld by American Automobile Company on salary credited to Mr. Sayres in that year?

Mr. Short: I object to the leading nature of the question.

The Court: I don't see that it's leading.

A. Yes, they took full credit for the taxes withheld.

Q. (By Mr. Cromwell): Did they take full—was that the full credit for the taxes withheld on the \$48,000? A. Yes.

Mr. Cromwell: Respondent has no further questions. [194]

Cross Examination

Q. (By Mr. Short): Would the W-2, or withholding tax memorandum furnished by the corporation to either of these taxpayers, during any

(Testimony of George Miller.)

year in which the salary of Mr. Sayres changed, agree with the actual amount received by Sayres for that year?

A. It can be reconciled to it, yes.

Q. That isn't what I asked you.

Mr. Short: Read the question.

(Second preceding question read.)

The Court: That is a rather hard question, isn't it?

(Second preceding question reread.)

Q. (By Mr. Short): Received or reported. Can you answer that?

A. Did you say, "Did they" or "Could they"?

Q. Were they the same?

A. No, they weren't.

Q. And the reason they are not the same is the difference in the reporting years of the corporation and the individual?

A. That is right.

Q. In examining—you stated that you had made examination not only of the records of the taxpayers Stanley and Madeleine Sayres, but of American Properties and American Auto, is that correct?

A. The pay roll records of the American Automobile.

Q. The what? [195]

A. The pay roll records of the American Automobile.

Q. Did you examine the resolutions of that corporation to determine what salary had been authorized to Sayres for either of those taxable years?

A. I cannot recall.

(Testimony of George Miller.)

Q. Is that the ordinary practice in making an examination of that type, salary examination?

Mr. Cromwell: To what are you referring?

Mr. Short: To examining the resolutions or other authority authorizing the salary.

A. Not necessarily.

Q. (By Mr. Short): Would you say that you did or did not examine the resolutions in this instance? A. I cannot recall. I am sorry.

Mr. Short: That is all.

(Witness excused.)

Mr. Cromwell: Respondent rests, your Honor.

Mr. Short: Petitioner rests, your Honor.

The Court: How about the briefs?

Mr. Cromwell: Simultaneous briefs would be what I prefer, your Honor.

Mr. Short: I think simultaneous briefs would be probably all right.

About 90 days? [196]

Mr. Cromwell: That suits me.

The Court: How about reply briefs?

Mr. Cromwell: 45 days.

Mr. Short: That is plenty of time.

The Clerk: Would you like those dates, gentlemen?

Mr. Cromwell: Yes, please.

Mr. Short: Yes.

The Clerk: The date will be August 20th for original briefs and on or before October 4th for reply briefs.

Mr. Short: That is the filing date, I assume?

The Court: Very well.

The case will stand submitted upon filing of the briefs.

Court will recess for about 15 minutes.

(Whereupon, at 10:35 o'clock a.m., the hearing in the above-entitled petition was closed.)

[Endorsed]: T.C.U.S. Filed June 6, 1956.

[Title of Tax Court and Docket Nos. 57748 and 57751.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 13, inclusive, constitute and are all of the original papers on file in my office as called for by the Designation of Contents of Record, except the original exhibits, admitted in evidence, which are separately certified, in the cases before the Tax Court of the United States docketed at the above numbers and in which the petitioners in the Tax Court have filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court cases, as the same appear in the official docket of my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United

States, at Washington, in the District of Columbia,
this 2nd day of June, 1958.

[Seal]

HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Endorsed]: No. 16051. United States Court
of Appeals for the Ninth Circuit. American Prop-
erties, Inc., and The Estate of Stanley S. Sayres,
deceased, Harold L. Scott and A. R. Munger, Ex-
ecutors, and Madeleine A. Sayres, Petitioners, vs.
Commissioner of Internal Revenue, Respondent.
Transcript of the Record. Petition to Review a
Decision of The Tax Court of the United States.

Filed: June 10, 1958.

Docketed: June 18, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

United States Court of Appeals
For The Ninth Circuit

No. 16051

AMERICAN PROPERTIES, INC., and the
ESTATE OF STANLEY S. SAYRES, De-
ceased, HAROLD L. SCOTT and A. R.
MUNGER, Executors, and MADELEINE A.
SAYRES, Petitioners on Review.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

STATEMENT OF POINTS

Come Now Petitioners On Review and make the following Statement of Points upon which they rely upon this Petition for Review:

1. The Tax Court erred in holding that the expenditures made by petitioner, American Properties, Inc., in 1949 and 1950 in connection with designing, constructing and racing of unlimited class hydroplanes did not constitute deductible business expense of the corporation.

2. The Tax Court erred in holding such expenditures to be personal hobby expenses of the corporation's sole stockholders, Stanley S. Sayres and Madeleine A. Sayres, and taxable income to said stockholders.

3. The Tax Court erred in determining deficiencies as to each petitioner in consequence of the foregoing findings.

4. The Tax Court erred in finding that the activities of petitioners with respect to the boats were not conducted with the intent of making a profit and that they did not constitute the conduct of a trade or business by any of petitioners.

/s/ KENNETH P. SHORT,
Attorney for Petitioners on
Review.

[Endorsed]: Filed June 18, 1958. Paul P.
O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

STIPULATION FOR CONSIDERATION OF EXHIBITS WITHOUT REPRODUCTION

It is stipulated between counsel for the respective parties that the exhibits heretofore transmitted to the Court in their original form by the Clerk of the Tax Court of the United States may be considered by the above entitled Court in their original form without reproduction.

Dated this 7th day of July, 1958.

/s/ KENNETH P. SHORT,
Attorney for Petitioners on Review.

/s/ CHARLES K. RICE,
Assistant Attorney General, Attorney for Respond-
ent on Review.

[Endorsed]: Filed July 9, 1958. Paul P.
O'Brien, Clerk.